
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

1987 FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended December 31, 1987

Commission File Number 1-5026

G A F CORPORATION

Delaware

(State of Incorporation)

1361 Alps Road, Wayne, New Jersey

(Address of Principal Executive Offices)

13-0762027

(I.R.S. Employer Identification No.)

07470

(Zip Code)

(201) 628-3000
(Telephone Number)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, par value \$1.00 per share	New York Stock Exchange
11 $\frac{1}{2}$ % Senior Subordinated Notes due 1995	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

As of March 10, 1988, 27,741,371 shares of common stock were outstanding. The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 10, 1988 was \$1,288,777,927. The aggregate market value was computed by reference to the closing price on the New York Stock Exchange of the registrant's Common Stock on such date (\$52.50). For purposes of this computation, voting stock held by executive officers and directors of the registrant has been excluded. Such exclusion is not intended, and shall not be deemed, to be an admission that such officers and directors are affiliates of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

The Company's Proxy Statement for the 1988 Annual Meeting of Shareholders is incorporated by reference in Part III, Items 10, 11, 12 and 13.

PART I

Item 1. Business.

The Company, a Delaware corporation, is engaged principally in the manufacture and sale of specialty chemicals and building materials. The Company was incorporated under the laws of the State of Delaware in 1929 and has its principal executive offices at 1361 Alps Road, Wayne, New Jersey 07470, telephone (201) 628-3000. Unless the context otherwise requires, the "Company" refers to GAF Corporation and its subsidiaries.

The Company's principal domestic operations are conducted through the following wholly-owned subsidiaries: (i) GAF Chemicals Corporation ("GAF Chemicals"), which operates seven specialty chemical plants and three mineral granules plants, (ii) GAF Building Materials Corporation ("GAF Building Materials"), which operates ten roofing plants, two glass fiber plants and one glass mat plant, and (iii) GAF Broadcasting Company, Inc. ("GAF Broadcasting"), which owns and operates a classical music FM radio station, WNCN, in the New York City market. The Company's international operations are conducted through a number of wholly-owned foreign subsidiaries, branches and independent distributors. In addition, a specialty chemical plant is operated by GAF-Hüls Chemie GmbH ("GAF-Hüls"), a joint venture between the Company and Hüls A. G. in Marl, West Germany and a specialty chemical plant is operated by Alkaril Chemicals Ltd. ("Alkaril"), a wholly-owned subsidiary of the Company, in Ontario, Canada.

Financial information concerning the Company's industry segments required by Item 1 is included in Note 11 of the Notes to the Company's Consolidated Financial Statements (the "Consolidated Financial Statements") on page F-19 of this Report.

GAF CHEMICALS CORPORATION

GAF Chemicals manufactures and sells two major groups of specialty chemicals (acetylene derivatives and surfactants) and a line of mineral roofing granules. These three product lines were organized in 1987 into separate business units, each with its distinct management, manufacturing operations and sales force.

Acetylene Derivatives

GAF Chemicals manufactures more than 75 different chemical products derived from acetylene. These specialty chemicals are sold primarily to the pharmaceutical, cosmetics, plastics, automotive, agricultural, textiles, oil and gas, paper and paint coatings industries worldwide. Manufacturing is vertically integrated so that chemicals are upgraded through numerous chemical reactions and other processing steps which add value and result in highly specialized and more complex products. These products are marketed in four groups: intermediates, solvents, polymers and vinyl ethers.

Intermediates are used by GAF Chemicals as raw materials in manufacturing solvents, polymers and vinyl ethers. These products are also sold to customers who use them in the manufacture of engineering plastics and other products.

Solvents are sold to customers as high performance products for use in agricultural chemicals, pharmaceuticals, binder resin and lithographic applications, wire and other coatings, plastics, electronic microchips and integrated circuits, and lubrication oil extraction and gas purification applications. They are also used by GAF Chemicals as raw materials in the processes leading to the manufacture of polymers and other downstream products.

Polymers are sold for specific applications under a number of trademarks and tradenames and are used in other downstream products. V-Pyrol® is used as a diluting agent in the radiation curing industry, as a comonomer for the manufacture of viscosity index improvers for premium motor oils as well as enhanced oil recovery chemicals and as a pigment dispersant. The major applications for polyvinyl pyrrolidone (PVP) polymers are in the cosmetic and pharmaceutical industries. PVP is used as a binder, stabilizer, protective agent, dispersant, film-former, adhesive detoxicant, viscosity modifier, solubilizer for pharmaceuticals and other products, drug and vitamin tablet binder, coating agent and processing aid in

fluid bed granulation. Polypladone XL and XL10 products are used as drug and vitamin tablet disintegrants. Polyclar® AT and Polyclar® 10 are used as clarifiers and chill-hazing agents for beer, wine, fruit juices and other beverages. PVP-Iodine is a water soluble, non-staining, microbiocidal product used in human and veterinary applications. Gafquat® products are film-forming polymers used in hair care products like the popular mousse products, as well as conditioners, gels and glazes. Ganex® polymers are used in cosmetic applications such as water-resistant eyeliner and lipstick, and industrial applications such as a film-former in shoe polishes and a dispersant in agricultural chemical formulations.

Vinyl Ethers are monomers and copolymers marketed under the Gantrez® trademark and are used in the cosmetic and pharmaceutical fields, primarily in hair and dental care products and in certain other industrial uses such as film-formers in coating and thickeners in detergent formulations.

Surfactants

GAF Chemicals manufactures and sells a broad line of surfactants (surface active agents) and specialty phosphate esters for use in numerous other chemical products. Surfactants are organic chemical compounds that possess detergent, emulsifying, dispersing, foaming, penetrating and wetting properties. A major part of surfactant output is used in the production of packaged soaps and detergents for household, industrial and institutional uses. The balance is used in pulp and paper making; the manufacture of agricultural chemicals, cosmetics, polymer emulsions, metal lubricants, paints and pharmaceuticals; textile and leather processing; oil drilling operations; and many other products.

GAF Chemicals' broadest surfactant product line is the Igepal® series sold primarily to customers for use in household, industrial and institutional detergents, latex paints and adhesives, and textiles. Other surfactants produced by GAF Chemicals are sold to customers for the same uses as the Igepal series and for specialized uses as down-hole flooding in oil and gas recovery, deresination of hardwood pulps, corrosion inhibitors, high and low foaming additives, agricultural dispersants and cosmetics.

In addition, over the past two years, GAF Chemicals has added complementary product lines through the acquisition of two surfactant businesses. In 1986, the Company acquired the surfactants and phosphate esters businesses of Borg-Warner Corporation, including a manufacturing facility in South Carolina. In November 1987, the Company acquired Alkaryl, a Canadian-based manufacturer of surfactants and other specialty chemicals, with manufacturing facilities in Georgia and Ontario, Canada. Alkaryl's product line includes surfactants, polyelectrolytes, dispersants, polyols, textile processing aids and other materials used in industrial, agricultural, metal working and consumer products. These acquisitions provide GAF Chemicals with new technology, increased manufacturing capacity, multiple manufacturing locations and additional research and development facilities.

Mineral Granules

GAF Chemicals mines and crushes basalt rock from its own quarries, producing various types of natural and ceramic coated mineral granules which it sells to the roofing industry for use as a mineral surface on asphalt roofing. The use of granules in roofing contributes substantially to its weathering capability and imparts the decorative coloration to shingles. Two groups of by-products from the manufacture of granules are also marketed as mineral filler for the asphalt coating of shingles and as tennis court materials.

GAF Chemicals' granules business continued to grow in 1987 benefiting, among other things, from the trend among roofing manufacturers to convert production to glass fiber substrate as the glass product requires more granules per unit of asphalt roofing. In addition, the increased popularity of heavyweight three dimensional shingles which simulate wood has increased granule demand in that they require more granules than lower-cost, commodity shingles. Granules and their by-products are sold to asphalt roofing manufacturers throughout most of the United States and in Canada. GAF Building Materials is GAF Chemicals' largest purchaser of granules. These purchases are at market prices.

Other Products

GAF Chemicals is the sole domestic producer of iron penta carbonyl and iron powders used in the aerospace, electronics, powder metallurgy, food and pharmaceuticals industries. FerronylTM iron supplement is sold as an additive for food and vitamins.

Raw Materials

The raw materials used in the production of chemical products are purchased from a large number of outside sources, in many cases pursuant to supply contracts. Certain of the raw materials, including acetylene, are obtained from limited sources pursuant to long-term supply contracts. With respect to acetylene, GAF Chemicals is supplied domestically at three locations by two suppliers. GAF Chemicals' products may also be manufactured from butanediol. Except for acetylene, GAF Chemicals believes that, in the event of interruption of supply of raw materials from current sources, it could obtain adequate supplies from alternate sources. With respect to acetylene, adequate supplies could be obtained by taking increased quantities from remaining sources, increasing shipments of butanediol from GAF-Hüls or obtaining butanediol from other suppliers.

Raw materials derived from petroleum or natural gas are used in many of GAF Chemicals' manufacturing processes and, consequently, the price and availability of petroleum and natural gas are material to the costs of operations. Generally, in 1987, crude oil prices increased, recovering from previous years' low levels. GAF Chemicals has obtained, and expects to continue to obtain, adequate supplies of these products at reasonable costs.

In connection with its mineral granules operations, GAF Chemicals owns three quarries, with proven reserves of more than twenty years each, located on property adjoining each of its three plants. Over the past few years, the Company has purchased land adjacent to its quarries for additional granules reserves and increased capacity at these plants.

International Operations

The Company's international operations, which are consolidated in the results of GAF Chemicals, consist principally of the marketing and distribution internationally of chemical products manufactured by GAF Chemicals in the United States. Subsidiaries and branches are located in various countries of Western Europe and in Australia, Brazil, Canada, Hong Kong, Japan, Mexico and Singapore. In certain locations, sales are made through distributors rather than through local subsidiaries. Major product lines sold internationally include intermediates such as butanediol, acetylenic specialties and surfactants.

The Company's foreign subsidiaries also market outside of the United States the filtration systems (consisting of filter bags manufactured by subsidiaries in Canada, Brazil and Belgium and hardware produced to the Company's specifications) which are used in the filtration of process liquids in the pharmaceuticals, cosmetics, paint, food and beverages industries. In early 1988, the Company commenced operation of a new plant in Brazil for the manufacture of filter vessels to be marketed in South America.

In addition, GAF-Hüls, the West German joint venture, operates a specialty chemical plant for the manufacture of butanediol, butynediol and tetrahydrofuran (THF), which are marketed through the Company's and GAF-Hüls' sales forces. One of the intermediates produced in that plant, butanediol, is also sold to GAF Chemicals for use as a feedstock in its United States plants to supplement domestic sources. See "Raw Materials" above.

The acquisition of Alkaril provided the Company with an additional plant for the manufacture of surfactants and other specialty chemicals, located in Mississauga, Ontario, Canada.

In 1987, the Company's international operations, including export sales from domestic operations, grew by 31.3% over 1986, and accounted for approximately 39.3% of GAF Chemicals' net sales. The Company's international sales benefited from the decline of the value of the dollar as well as from a strong demand for certain of its acetylene derivatives, particularly in the cosmetics and pharmaceuticals markets. The Company does not believe there are any unusual risks attendant on its foreign operations. See also Note 12 of the Notes to Consolidated Financial Statements on page F-20 for financial information by geographic areas.

Patents, Trademarks, etc.

The Company owns approximately 431 domestic and 382 foreign patents and approximately 138 domestic and 667 foreign trademark registrations related to the business of GAF Chemicals. The Company believes its rights under its existing patents and patent applications to be material in order to maintain its present position in the industry. The duration of the existing patents and patent licenses is deemed generally satisfactory.

Seasonal Variations, Working Capital, Customers

Seasonal variations are generally not material to the business of GAF Chemicals.

Inventory balances are generally sufficient to meet customer demand and do not materially deviate from standards for the industry. GAF Chemicals does not generally provide extended payment terms to customers.

GAF Chemicals sells to a wide variety of industrial customers with particular emphasis on the pharmaceutical and cosmetics industries. No single customer or group of customers under common control is responsible for sales in excess of 10% of the consolidated revenues of the Company. In certain instances a single customer may purchase all, or a significant part, of the output of a particular product. The Company does not believe that the loss of any one such customer would have a material adverse effect on the business of GAF Chemicals.

Backlog, Government Sales, Method of Distribution, Competitive Conditions

Backlog is not material to the business of GAF Chemicals.

Sales to the federal government are not material to the business of GAF Chemicals.

GAF Chemicals sells its products primarily through its own sales force in the United States.

GAF Chemicals is the sole United States producer of a complete line of high-pressure acetylene-based chemicals. GAF Chemicals competes in its acetylene derivatives line with a major foreign competitor and with another large company which manufactures substantial quantities of butanediol and THF for its own use and for sale to others. However, no single company is dominant in the industry with respect to these products.

In the balance of its chemical businesses, GAF Chemicals competes with many companies, certain of which are substantially larger than GAF Chemicals and offer a broader range of products. Generally, GAF Chemicals has responded to this competition by emphasizing product innovation, product quality, reliability of supply and customer service. The Company believes that the great size and diversified nature of the chemical industry makes it impossible to give a meaningful estimate of the relative position of GAF Chemicals in the industry.

Research and Development

Research and Development expenses for both GAF Chemicals and GAF Building Materials in 1987, 1986 and 1985 are presented in Note 1 of the Notes to Consolidated Financial Statements appearing on page F-11. Most of the amounts shown were expended by GAF Chemicals.

As of December 31, 1987, 175 employees were engaged in the Company's research and development. In 1987, GAF Chemicals continued to expand its commitment to its research and development activity with new products, new processes, new applications for existing products and custom-tailored products to respond to specific customer needs and changing safety and health requirements in the U.S. and abroad. This research and development program, which has grown substantially each year since 1983, led to the design, testing and production for sale or customer evaluation of a number of new or improved products in each of its product lines in 1987, including the introduction into the market of the first two Surfadone™ products, which combine GAF Chemicals' surfactant and acetylene chemistries.

The Company expended \$674,000, \$911,866 and \$568,451 on customer-sponsored research and development services for the years 1987, 1986 and 1985, respectively.

GAF BUILDING MATERIALS CORPORATION

GAF Building Materials manufactures and sells roofing materials to the residential and commercial industries.

Residential Roofing

GAF Building Materials is a leading manufacturer of a complete line of residential roofing products.

GAF Building Materials' principal products are its Sentinel®, Royal Sovereign®, GAF Wood Line™ and Timberline® brand shingles. Shingles are made from fiber glass mat, coated with waterproofing asphalt on both sides and surfaced with ceramic coated mineral granules. Sentinel shingles are GAF Building Materials' standard strip shingle line and residential volume leader. Royal Sovereign shingles are designed to capitalize on the emerging "middle market" for quality roofing shingles at a slightly higher price than standard Sentinel shingles. Timberline premium roofing shingles are a heavyweight and laminated product which offers the appearance of a wood shake shingle but with a superior fire resistance and durability. GAF Wood Line shingle, a newly designed mid-weight laminated asphalt shingle with a Class A fire rating, is expanding nationally, and gaining acceptance by builders as an economical trade-up for buyers of strip shingles.

Timbertex™ hip and ridge shingles and Weather Watch™ ice and water barrier, a waterproof underlayment, were successfully introduced in 1987. The introduction of these products enabled GAF Building Materials to be first in the industry to offer a complete system of residential roofing components.

Commercial Roofing

GAF Building Materials markets a full line of built-up roofing and modified bitumen products and accessories for use in the application of commercial roofing. These commercial products are assembled on the roof by applying successive layers of roofing membrane with asphalt, and, in some applications, gravel. Thermal insulation may be applied beneath the membrane.

GAF Building Materials manufactures a quality glass membrane under the trademark GAFGLAS®, which is made from asphalt impregnated glass fiber mat, for use as a component in built-up roofing. GAF also manufactures base sheets, flashings, and package asphalt for use in these systems. In addition, GAF Building Materials sells accessories such as vent stacks, roof insulation fasteners, cements and coatings.

Introduced in 1986, modified bitumen products sold under the trademark Ruberoid® MB were very successful in 1987, especially in small re-roofing applications. These products consist of a roofing membrane utilizing polymer modified asphalt reinforced with a tough polyester nonwoven mat. Modified bitumen systems provide high performance characteristics, such as weather and water resistance, and labor cost savings due to ease of application.

Raw Materials

The major raw materials required for the manufacture of GAF Building Materials' roofing products are asphalt, glass fiber, glass fiber mat, filler (generally crushed or pulverized limestone, granite or sand) and granules. Asphalt and filler are available from a large number of suppliers. GAF Building Materials currently has contracts with several of these suppliers, with others available as substitutes. Prices of most raw materials have been reasonably stable, rising moderately with general industrial prices. The price of asphalt tends to move in step with the price of crude oil. GAF Building Materials has obtained, and expects to continue to obtain, supplies of raw materials at reasonable costs. Five of GAF Building Materials' roofing plants have easy access to deep water ports allowing delivery of asphalt by ship, the most economical means of transport. GAF Building Materials has a plant which makes glass fiber mat for internal consumption and two plants which manufacture chopped glass fiber for mat substrate, permitting complete integration of the roofing manufacturing process.

Patents, Trademarks, etc.

The Company owns approximately 41 domestic and 46 foreign patents and approximately 65 domestic and 185 foreign trademark registrations related to the business of GAF Building Materials. The Company believes the patent protection covering certain of its products to be material to those products, but patents are not of material significance to the business of GAF Building Materials, nor to the industry generally. The duration of the existing patents and patent licenses is deemed generally satisfactory.

Seasonal Variations, Working Capital, Customers

Sales of roofing products in the northern regions of the United States generally decline during the winter months due to adverse weather conditions. To maintain a more constant level of manufacturing and sales, GAF Building Materials has followed in 1987, as well as in previous years, the practice of "winter dating" in such regions, pursuant to which advantageous extended credit terms are offered to creditworthy customers who order and accept delivery of roofing products during the winter months. A "winter dating" program is also being offered to customers in 1988.

No single customer or group of customers under common control is responsible for sales in excess of 10% of the consolidated revenues of the Company.

Generally, GAF Building Materials' inventory practices include increasing inventory levels throughout the first quarter in order to meet peak season (April through October) demand.

Backlog, Government Sales, Method of Distribution, Competitive Conditions

Backlog is not material to the business of GAF Building Materials.

Sales to the federal government are not material to the business of GAF Building Materials.

GAF Building Materials markets its roofing products through its own sales force with district sales offices located across the United States. A major portion of its sales are to wholesale distributors who resell to roofing contractors and dealers. The remainder of the sales are either to retailers who sell to the consumer market or direct sales to the construction industry.

The roofing products industry is highly competitive and includes at least six major competitors, including GAF Building Materials, and numerous smaller regional competitors. Competition is based largely upon product and service quality, distribution capability, price and credit terms. GAF Building Materials is well positioned in the marketplace as a result of strong sales and distribution capabilities, favorable raw material costs and broad product lines.

For several years, prices in the roofing industry have declined. To meet this trend, GAF Building Materials maintains aggressive programs to reduce raw material and other costs, automate production facilities, introduce new products, emphasize sales of profitable high value-added products and maintain sales at a relatively high level in relation to plant capacities.

Research and Development

GAF Building Materials is engaged in new products development and process improvements which have led to cost savings, increased manufacturing efficiencies and the introduction of five new major products in the past 4 years: the Royal Sovereign and GAF Wood Line shingles, Ruberoid MB modified bitumen, Timbertex hip and ridge and Weather Watch underlayment. In addition, GAF Building Materials just announced the following new product introductions: in the commercial roofing area, GAFGLAS® Ply #6 high-strength membrane and new flashing accessories for the Ruberoid MB line; in the residential roofing area, Slateline™ asphalt shingle which offers the appearance of slate, a Class A fire rating and labor savings because of its extra large dimension.

GAF BROADCASTING COMPANY, INC.

GAF Broadcasting owns and operates WNCN, 104.3-FM, a commercial radio station broadcasting classical music and cultural programs in the New York City metropolitan area. WNCN is on the air 24 hours a day, 7 days a week. GAF Broadcasting also publishes a monthly magazine, Keynote, which is devoted to classical music and the arts and includes a program guide for the radio station.

See "Item 3. Legal Proceedings" below for a description of a pending lawsuit concerning WNCN.

Protection of the Environment

The discussion as to asbestos-related and environmental lawsuits involving the Company, and appearing in response to "Item 3—Legal Proceedings" below, is incorporated herein by reference.

Since 1970, a wide variety of federal, state and local environmental laws and regulations have been adopted and continue to be adopted and amended. By reason of the nature of the Company's past and present operations and certain of the substances which are, or have been, used, produced or discharged by the Company's plants, capital expenditures and increased operating expenses, the amount of which cannot be estimated at this time, may be occasioned by the Company's continuing efforts to comply with applicable laws and regulations or otherwise to deal responsibly with environmental matters.

The Company believes that compliance with environmental control requirements will not materially affect its earnings and its competitive position in the industries in which it is engaged. The Company currently has plans to invest approximately \$8 million in 1988, \$10.5 million in 1989 and \$9.4 million in 1990 in pollution abatement facilities. Imposition of future, more stringent requirements in waste water discharge and ground water protection may require capital expenditures not included in the amounts stated above.

Executive Officers of the Registrant

The following table sets forth the names, ages, present positions and business experience for at least the last five years of all executive officers of the Company. Officers are appointed to serve until the meeting of the Board of Directors following the next Annual Meeting of Shareholders and until their successors have been elected and have qualified.

<u>Name</u>	<u>Age</u>	<u>Present Position</u>	<u>Prior Business Experience</u>
Samuel J. Heyman (1)(2)(3)(4)	49	Chairman of the Board and Chief Executive Officer since 1983	Chief Executive Officer, Manager and General Partner of closely-held companies and partnerships whose investments include commercial real estate and a portfolio of publicly traded securities held largely in connection with arbitrage related investments.
James T. Sherwin (1)(3)	54	Vice Chairman and Chief Administrative Officer since 1984	Executive Vice President—Finance and Administration, GAF Corporation, 1974 to 1983. Mr. Sherwin has been employed by GAF Corporation in various other positions since 1960; Executive Vice President and Chief Financial Officer, Triangle Industries, May 1983 to May 1984.
Heinn F. Tomfohrde, III	54	Executive Vice President and President, GAF Chemicals Corporation since 1987	Group President, Specialties & Services (1986-1987), President and Chief Operating Officer, Consumer & Industrial Products & Services (1985-1986), Executive Vice President, Engineering & Technology Services (1983-1985) and a director (1985-1987), Union Carbide Corporation.
Carl R. Eckardt (1)	57	Executive Vice President, Corporate Development since 1987	Senior Vice President, Chemicals (1984-1987), President, Chemicals Division (1985-1987), Vice President (1979-1984), GAF Corporation; President, GAF Chemicals Corporation (1985-1986). Mr. Eckardt has been employed by GAF Corporation in various other positions since 1974.
John A. Brennan	56	Executive Vice President and President, GAF Building Materials Corporation since 1987	Senior Vice President, Building Materials (1984-1987), President, GAF Building Materials Division (1985-1986), Vice President (1977-1984), GAF Corporation; President, GAF Building Materials Corporation (1986-present). Mr. Brennan has been employed by GAF Corporation in various other positions since 1971.
Irving Kagan	52	Senior Vice President, General Counsel and Secretary since 1986	Senior Vice President & General Counsel, The Hertz Corporation (1983-1986). Mr. Kagan served in various other legal and management positions from 1968-1983 with The Hertz Corporation.
Joel A. Asen	37	Senior Vice President, Treasury and Business Development since 1987	Vice President, Treasury & Business Development (1985-1986), GAF Corporation; Corporate Manager of Business Development, General Electric Corporation (1984-1985); Manager, Business Development & Marketing Operations, Manager-Operational Planning & Business Development, Manager-Operations Analysis & Strategic Planning, General Electric Credit Corporation (1981-1984).

(1) Member, Board of Directors

(2) Member, Executive Committee

(3) Member, Retirement Committee

(4) Member, Investment Committee

No arrangements or understandings exist between any executive officer and any other person pursuant to which the officer was selected as such. There is no family relationship between any of the executive officers.

Employees

At January 1, 1988, the Company employed approximately 4,635 people worldwide. At such date, approximately 1,809 employees in the United States and Canada were subject to 21 union contracts, which are effective in most cases for two-or three-year periods. Of these contracts, 8 have expired or will expire in 1988. During 1987, there were no strikes or work stoppages.

The Company has in effect various benefit plans which include a non-qualified deferred compensation plan for a group of executives, a capital accumulation plan for its salaried employees, a flexible benefit plan for its salaried employees, a retirement plan for its hourly paid employees, and group insurance agreements providing life, accidental death, disability, hospital, surgical, medical and dental coverage. In addition, the Company has contracted with various health maintenance organizations to provide medical benefits. The Company and, in many cases, the employees contribute to the cost of the above described plans.

Other Corporate Developments

The Company holds a variety of short-term investments in domestic and foreign instruments, including preferred and common stock, fixed income securities and risk arbitrage, dividend capture and stock/futures arbitrage positions, commercial paper, and repurchase agreements, selected to maximize income return. The average amount invested in these programs during 1987 was approximately \$647 million. These investments are reviewed on a regular basis by the Audit Committee of the Board of Directors and by the full Board.

The Company from time to time purchases securities in other corporations. During 1986, the Company acquired over 9% but less than 10% of the outstanding common stock of Borg-Warner Corporation ("Borg-Warner") and CBI Industries, Inc. ("CBI"). During 1987, the Company made a tender offer proposal for Borg-Warner but subsequently tendered its holdings into a competitive tender offer. (See description below.) As of the end of 1987, the Company continued to hold its position in CBI, as well as positions in the stock of other publicly-owned companies. Financial information concerning the Company's investments is included in Note 2 of the Notes to the Consolidated Financial Statements on page F-12 and in Schedule I, on page S-1.

After having accumulated an additional 9.9% of the outstanding common stock of Borg-Warner during the first quarter of 1987, bringing the Company's holding in Borg-Warner to approximately 19.9%, the Company, on March 31, 1987, made an all-cash merger offer to Borg-Warner at \$46 per share for all of that company's outstanding common stock. After Borg-Warner's announcement that it had endorsed a competitive offer made by an affiliate of Merrill Lynch Pierce Fenner & Smith, Inc., the Company announced on April 27, 1987 that it had decided to withdraw its offer and then tendered 16.4 million shares of common stock of Borg-Warner into the Merrill Lynch offer. The Company's remaining shares were exchanged in the third quarter for cash and bonds. As of December 31, 1987, the Company had realized a pretax profit, after expenses, of approximately \$206 million in connection with this investment.

The Company announced on April 27, 1987 that its Board of Directors had authorized the repurchase of up to three million shares of the Company's common stock for cash in open market purchases and privately negotiated transactions. As of August 5, 1987, the last date on which repurchases were made pursuant to the April 27th authorization, the Company had repurchased 2,121,469 shares at a total cost of \$103.1 million, an average price per share of \$48.62.

On September 8, 1987, the Company received a proposal for a buyout of the Company from a management-led group headed by Samuel J. Heyman, the Company's Chairman and Chief Executive Officer. Under the proposal, shareholders would have received \$64 in cash and \$2.50 principal amount of 15% junior subordinated debentures for each share of common stock of the Company. On October 19, 1987, Mr. Heyman advised the special committee of independent directors of the Company, appointed to evaluate the buy-out proposal on behalf of the Company (the "Special Committee"), that the management group intended to reconsider its acquisition proposal in light of then current stock market conditions.

On October 20, the Board of Directors withdrew the April 27th authorization to repurchase up to three million shares of common stock of the Company and, under a new program, authorized the repurchase of

up to seven million shares for cash in open market purchases and privately negotiated transactions. As of December 4, 1987, the last date on which repurchases were made pursuant to the October 20th authorization, the Company had repurchased 5,857,200 shares at a total cost of \$219.9 million, an average cost per share of \$37.54.

On December 14, 1987, the Company received a revised proposal for a buy-out of the Company from the management group, which offered to pay \$40 in cash and \$8.50 principal amount of 13% junior subordinated debentures for each share of common stock of the Company.

On February 29, 1988, the Company entered into an agreement with the management group under which it was agreed that the Company's Board of Directors would submit to shareholders an increased offer from the management group to acquire the Company. Under the terms of the increased offer, shareholders would receive for each of their shares \$46 in cash and \$6.50 principal amount of junior subordinated debentures intended to have a value of at least \$5 on a fully distributed basis. Pursuant to the terms of the agreement, the Board of Directors will submit for shareholder approval an amendment to the Company's charter empowering shareholders to act as and in place of the Board to enter into a merger agreement. If a majority of the outstanding shares of common stock approves the amendment, shareholders would then decide whether the merger agreement with the management group should be executed. A second shareholder vote would thereafter be required under Delaware law to consummate the merger.

The management group has informed the Special Committee that it expects to finance the transaction primarily with its own funds and bank borrowings under a syndicated loan from a group of banks to be led by The Chase Manhattan Bank, N.A., with a portion of the transaction being financed through an underwritten offering of senior subordinated debt securities.

Although the Special Committee was unable to endorse the proposal because of the belief of all of the members of the Special Committee that it does not adequately reflect the long-term values of the Company, the majority of the Special Committee believed that shareholders should be afforded the opportunity to consider the revised offer in light of the opinion of Salomon Brothers Inc, retained by the Special Committee to evaluate management's proposal, that such proposal is fair to shareholders from a financial point of view and of the instructions of the Special Committee to Salomon Brothers to solicit other possible purchasers for the Company. The decision to submit to shareholders the charter amendment and the merger proposal was made by five of the seven members of the Special Committee (with Messrs. Daniel T. Carroll and William P. Lyons, who do not favor submitting the charter amendment for shareholder approval, dissenting). Under the terms of the agreement, if an economically superior alternative proposal is received for the Company, the Special Committee may terminate the agreement with the management group.

It is expected that shareholders will consider the charter amendment and the management group's merger proposal at the Company's 1988 Annual Meeting, which will be held after a registration statement with respect to the debentures to be issued in the merger is declared effective and a proxy statement is mailed to shareholders.

Item 2. Properties.

The corporate headquarters, principal research and development laboratories, general administrative and financial operations and principal electronic data processing facility of the Company and of its subsidiaries, GAF Chemicals and GAF Building Materials, are located on 100 acres of land and in 10 buildings at 1361 Alps Road, Wayne, New Jersey 07470. The Company leases the facilities and land from a wholly-owned subsidiary, GAF Realty Corporation. The premises are subject to a first mortgage.

The WNCN-FM studio and GAF Broadcasting are located in leased offices at 1180 Avenue of the Americas, New York, New York 10036.

The Company's principal domestic and foreign real properties are either owned by, or leased to, the Company or its subsidiaries as described in the list below. Unless otherwise indicated, the properties are

owned in fee. In addition to the principal facilities listed, the Company maintains sales offices and warehouses in the United States and in nineteen foreign countries, substantially all of which are in leased premises under relatively short-term leases.

<u>Location</u>	<u>Facility</u>	<u>Segment</u>
Alabama		
Huntsville	Plant*	Chemicals
Mobile	Plant, Sales Office	Building Materials
California		
Fontana	Plant, Sales Office	Building Materials
Irwindale	Plant	Building Materials
Florida		
Tampa	Plant, Sales Office	Building Materials
Georgia		
Savannah	Plant, Sales Office	Building Materials
Winder	Plant, Sales Office, Research	Chemicals
Indiana		
Mount Vernon	Plant, Sales Office	Building Materials
Kentucky		
Calvert City	Plant	Chemicals
Maryland		
Baltimore	Plant	Building Materials
Hagerstown	Research	Chemicals (granules)
Massachusetts		
Millis	Plant, Sales Office	Building Materials
Minnesota		
Minneapolis	Plant, Sales Office, Warehouse*	Building Materials
Missouri		
Annapolis	Plant, Quarry	Chemicals (granules)
New Jersey		
Bound Brook	Plant, Sales Office	Chemicals (granules)
Linden	Plant, Sales Office	Chemicals
Wayne	Corporate and Subsidiaries Head- quarters*, Administrative Offices*, Research*	Corporate, Building Materials, Chemicals
New York		
New York	Office, Studios*	GAF Broadcasting
Pennsylvania		
Blue Ridge Summit	Plant, Quarry	Chemicals (granules)
Erie	Plant, Sales Office	Building Materials
South Carolina		
Chester	Plant	Building Materials
Spartanburg	Plant	Chemicals
Tennessee		
Nashville	Plant, Research	Building Materials
Texas		
Dallas	Plant, Sales Office	Building Materials
Seadrift	Plant	Chemicals
Texas City	Plant	Chemicals
Wisconsin		
Pembine	Plant, Quarry	Chemicals (granules)

INTERNATIONAL

Belgium		
Sint-Niklaas.....	Sales Office, Distribution Center	Chemicals
Brazil		
Sao Paulo	Plant*, Sales Office,* Distribution Center*	Chemicals
Canada		
Mississauga, Ontario.....	Sales Office,* Distribution Center*	Chemicals
Mississauga, Ontario.....	Plant, Sales Office, Research	Chemicals
Great Britain		
Guildford.....	European Headquarters*, Research	Chemicals
Singapore		
Singapore	Sales Office*, Distribution Center,* Regional Headquarters,* Warehouse*	Chemicals
Affiliate:		
GAF-Hüls Chemie GmbH Marl, West Germany	Plant, Sales Office	Chemicals

* Leased Property

The Company believes that, in general, these plants and facilities, which are of widely varying ages and of different types of construction, have been adequately maintained, are in good condition and are suitable and adequate for the Company's operations. The Company's major facilities are, in general, satisfactorily utilized and in certain product lines operated in 1987 at near or full capacity. Each plant has adequate transportation facilities for both raw materials and finished products. As part of the Company's continuing capital expansion and improvements program, major projects for the renovation of some of the plants and installation of new equipment have been completed in 1987 and more are planned. Capital expenditures were \$65.9 million in 1987 and are expected to be approximately \$74 million in 1988.

Item 3. Legal Proceedings.

As of December 31, 1987, the Company was a co-defendant in approximately 33,000 pending lawsuits involving alleged health claims relating to the inhalation of asbestos fiber. The Company has resolved approximately 24,000 other lawsuits involving similar claims through December 31, 1987. The great majority of these cases have been filed in the last seven years. It is anticipated that additional suits will be filed by persons allegedly exposed to asbestos at sites where it is claimed asbestos containing materials manufactured by the Company and others may have been used. It is impossible to predict the number of such additional lawsuits. In 1971, the Company discontinued the sale of its principal asbestos insulation products and in 1975 withdrew from sale of all asbestos products except products in which the asbestos fiber was fully bonded or encapsulated, which products the Company discontinued in 1981.

In May 1979, the Company commenced an action in the Los Angeles, California Superior Court against its insurance carriers to obtain a judicial determination that the defendants are obligated to defend and indemnify the Company, under policies issued from 1947 to 1979, in all present and future asbestos bodily injury cases. In addition, the Company sought compensatory and punitive damages for breach of insurance contracts, violations of the California Insurance Code, bad faith and certain other claims. The action was later consolidated in the San Francisco Superior Court with actions by other asbestos producers against their insurers. Trial commenced in March 1985, and a decision on the third phase of this case was rendered on May 29, 1987, with the Court holding, *inter alia*, that insureds are entitled to coverage for asbestos personal injury claims under all insurance policies in effect from the date of the claimants' initial

exposure through the earlier of diagnosis of disease or death. The remainder of the trial is expected to continue through 1988 or longer due to the numerous and complex insurance coverage issues and the number of litigants.

In January 1987, the Company entered into settlement agreements with five of its defendant-carriers in the California litigation described above. These five settlements resolve all of the Company's outstanding claims against these insurers with respect to their asbestos bodily injury coverage and will provide the Company with substantial insurance with respect to pending and prospective asbestos bodily injury claims and related expenses. These carriers have been dismissed from that litigation. However, the Company's suits against the remaining insurers in that litigation continues. Additionally, in October 1986, the Company commenced a declaratory judgment action in Los Angeles, California Superior Court with respect to the obligations for asbestos bodily injury coverage of certain underwriters at Lloyd's and British insurance companies under liability policies issued to the Company for the years 1979 to 1983.

In connection with the settlements described above, the Company joined the Wellington Asbestos Claims Facility (the "Facility"), an organization of insurance companies and asbestos producers formed in 1985 to coordinate the administration of asbestos bodily injury claims. From and after January 7, 1987, the Facility has also assumed defense and settlements of the Company's pending, threatened and future asbestos bodily injury claims. The Company's share of the costs of settlements, judgments and legal expenses, with respect to all claims handled by the Facility, are borne by the Facility, which is reimbursed by the Company's insurers on the basis of the amounts provided under the Facility's agreement with the Company, and to the extent of the coverage afforded the Company under its policies of insurance and the settlement agreements. At the same time, the Company entered into a separate agreement with another insurer, with which the Company had previously settled its insurance coverage claims, so as to conform the Company's arrangement with such insurer regarding such settlements and with the Company's entry into the Facility.

In the opinion of management, based in part on the opinion of its General Counsel with respect to the aforesaid health claim lawsuits, the California litigation described above, the aforesaid January 1987 settlements with certain insurance carriers and the Company's entry into the Facility, the ultimate disposition of such lawsuits and litigation will not have a material adverse effect on the Company's financial position.

As of December 31, 1987, the Company was a defendant in approximately 76 pending actions commenced by school districts, municipalities and similar governmental entities and building owners which allege economic and property damage or other injuries in schools or public and private buildings caused, in whole or in part, by what is claimed to be the present or future need to remove asbestos material from those premises. The plaintiffs seek to recover the cost of inspections, removal and/or the replacement of asbestos materials plus health screening examinations, counsel fees and expenses incurred in connection with the litigation and compensatory and punitive damages. These actions are still in early stages. One of these lawsuits, in the U. S. District Court for the Eastern District of Pennsylvania, has been certified as a class action for certain issues, including punitive damages. This case is in the pre-trial stage. The Company did not sell asbestos spray or acoustical ceiling products, which are the primary products being removed from buildings.

In October 1983, the Company filed a lawsuit in Los Angeles, California Superior Court against its past insurance carriers to obtain a judicial determination that defendants are obligated to defend and indemnify the Company in the asbestos-in-building cases referred to in the preceding paragraph. The Company is seeking declaratory relief as well as compensatory damages. This action is presently in the pre-trial pleading stage. The parties have agreed to hold this action in abeyance until such time as they are better able to evaluate developments as they may occur in the underlying asbestos-in-building cases. One of the Company's insurance carriers is currently paying, under reservations of rights, all costs of defense of the asbestos-in-building litigation. Because such litigation is in its early stages and evidence and interpretations of important legal questions are presently unavailable, it is not possible to predict the future of such litigation. In the opinion of management, based in part on the opinion of its General Counsel with respect to the aforesaid asbestos-in-building lawsuits and the October 1983 litigation described above, the ultimate disposition of such lawsuits and litigation will not have a material adverse effect on the Company's financial position.

On February 2, 1981, an action was commenced against the Company and GAF Broadcasting by Concert Radio, Inc. in the Supreme Court, County of New York, seeking specific performance, or, in the alternative, damages arising out of the alleged breach of an option agreement for the purchase of radio station WNCN. In 1984, the trial court ruled in favor of the plaintiff and ordered specific performance of the option agreement. The Company appealed such judgment to the New York Supreme Court, Appellate Division. In May 1985, the Appellate Division affirmed the trial court ruling that the Company has breached the option agreement to sell radio station WNCN to Concert Radio, Inc., but reversed the portion of the judgment ordering specific performance, thus limiting plaintiff to monetary damages for which a new trial was ordered. In May 1987, the parties stipulated damages at \$2,500,000 plus interest, and judgment was entered in August 1987. Plaintiff then moved in the Appellate Division for leave to appeal to the Court of Appeals the denial of specific performance. In November 1987, the Appellate Division denied leave and plaintiff subsequently moved in the Court of Appeals for leave to appeal. The Company has cross-moved for leave to appeal. The motion and cross-motion are pending.

The Company is a party to a variety of administrative proceedings and lawsuits involving environmental matters, including being named as a defendant, together with numerous other companies, in several lawsuits under the Comprehensive Environmental Response, Compensation and Liability Act (commonly known as "CERCLA" or the "Superfund Law") and similar state laws which seek to recover from generators of hazardous waste the cost of cleaning up so-called "orphan" waste disposal sites. Most of the lawsuits involving orphan dumpsites are in the early stages. Due to the practices of waste disposal haulers and disposal facilities prior to adoption and implementation of the environmental laws and regulations, evidence is difficult to obtain or evaluate and important legal questions have not yet been answered. The Company plans to seek dismissal of some of the lawsuits and proceedings on grounds that there appears to be no substantial evidence that there is any hazardous waste of the Company present at the dumpsites in question. In other cases, the Company will seek such resolution as may be appropriate. In each lawsuit, it is expected that liability, if any, will eventually be apportioned among the companies found responsible for the presence of hazardous waste at the dumpsite. Based on evidence presently available, it is impossible to predict the eventual liability of the Company in these orphan dumpsite lawsuits. In the opinion of management, based in part on the opinion of its General Counsel, these lawsuits should be resolved gradually over a period of years for amounts which are not material in the aggregate to the business or financial position of the Company.

Each of the directors (except Messrs. Sherwin and Eckardt) is named as a defendant together with the Company in a lawsuit commenced in New York State Supreme Court, New York County, by Jesse Werner, the former Chairman and Chief Executive Officer of the Company, alleging that they wrongfully prevented him from exercising options to purchase 240,000 shares of common stock of the Company and seeking to recover \$800,000 in compensatory damages and \$5,000,000 in punitive and exemplary damages. In April 1986, Werner died and his estate was substituted as a party in all proceedings. A motion to amend the complaint, opposed by the Company, to increase the damages sought to \$13,897,000 and \$20,000,000, respectively, based primarily on the increase in the price of common stock since the commencement of the action, has been granted. The Court, however, ruled, in response to a motion by the Company, that the estate would be precluded from introducing evidence in support of its amended compensatory damage claim, and that damages, to the extent any are awarded, must be measured by and limited to the difference between the market price of the stock at the time exercise of the option was denied to Werner and the exercise price of the options. In the alternative, the amended complaint seeks specific performance of Werner's options. In March 1984, the Company commenced a lawsuit in New York State Supreme Court, New York County, against Werner and certain former directors of the Company seeking to recover compensatory damages in connection with Werner's compensation arrangements and costs incurred in waging the 1983 proxy contest plus \$50,000,000 in punitive damages. A third party complaint filed against Mr. Sherwin in that action has been dismissed by the Court. Werner also commenced an arbitration proceeding with respect to his employment agreement, dated September 17, 1981, which the Company declined to perform after the present management assumed office in December 1983. In June 1987, the arbitration panel awarded Werner's estate the sum of \$2,827,191, including interest, in disposition of the estate's claim of \$7,590,317, which award has been paid by the Company. The foregoing lawsuits brought by Werner's estate and the Company are continuing. Under the Company's By-Laws and the Delaware

General Corporation Law, the present and former directors and officers of the Corporation are entitled to indemnification against certain liability, costs and expenses in any action, suit or proceeding as a result of their service in such capacity unless it is finally determined that they failed to act in good faith and in a manner which they reasonably believed to be in, or not opposed to, the best interests of the Company. The Company maintained company reimbursement and directors and officers liability insurance policies which were in effect during the period when the foregoing lawsuits were commenced and which should provide for reimbursement of amounts that might be paid in fulfillment of such indemnification obligation.

Several lawsuits are pending in the courts of New York and Delaware which were commenced by shareholders of the Company during the 1983 proxy contest as a result of which Samuel J. Heyman replaced Werner as Chairman and Chief Executive Officer. These lawsuits name as defendants Werner, and certain former directors, including James T. Sherwin, who is a present director. The complaints in these lawsuits make a variety of allegations against the former Chief Executive Officer and the former directors including mismanagement, corporate waste, breach of fiduciary duties and securities law violations. The defendants have answered and denied these allegations. The former directors may be entitled to indemnification by the Company and coverage under its directors and officers liability insurance policy to the extent described in the preceding paragraph.

In response to the management-led group's September 8, 1987 buyout offer (see "Item 1—Other Corporate Developments" above), 21 actions were commenced in the Delaware Court of Chancery, New Castle County. By order of the court, these actions were subsequently consolidated into one action. The Company and all of its present directors were named as defendants in the consolidated action. The consolidated action was styled as a class action and was brought on behalf of all shareholders of the Company other than the named defendants. The action alleged, *inter alia*, that the price proposed to be paid by the management group was inadequate and, as a result, the defendants breached their fiduciary duties to the Company's shareholders. The action sought to enjoin the proposed transaction or to rescind it in the event it was already consummated. On February 29, 1988, in connection with the management group's increased buyout offer and the agreement with the Company to submit that revised proposal to shareholders in accordance with the procedure described above in "Item 1—Other Corporate Developments," the plaintiffs and the defendants entered into an agreement to settle the consolidated action. Consummation of the settlement is subject to the completion of such additional discovery as may be necessary and to court approval.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during the fourth quarter of 1987.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Market for Common Stock

On March 10, 1988, the closing price on the New York Stock Exchange for the Company's common stock was \$52½, and there were 19,997 holders of record of the Company's outstanding common stock. The following information pertains to the Company's common stock, which is traded on the New York Stock Exchange.

	Cash Dividends Per Common Share		Price Range of Common Stock			
			1987		1986	
	1987	1986	High	Low	High	Low
First Quarter	\$.025	\$.025	\$49½	\$36½	\$37½	\$23¾
Second Quarter .....	.025	.025	56	45½	37¼	32
Third Quarter.....	.025	.025	69½	52¾	36¾	28¾
Fourth Quarter.....	.025	.025	64¾	31¾	44	32¾

Item 6. Selected Financial Data

See page F-6

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

See page F-2

Item 8. Financial Statements and Supplementary Data

See Index on page F-1

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

PART III

Item 10. Directors and Executive Officers of the Registrant.

The information required by Item 10 as to directors is incorporated by reference to the Proxy Statement for the Company's 1988 Annual Meeting of Shareholders (the "Proxy Statement") under the caption "Proposal No. 4—Election of Directors—Nominees". For the information required as to Executive Officers, see "Item 1. Executive Officers of the Registrant".

Item 11. Executive Compensation.

The information required by Item 11 is incorporated by reference to the Proxy Statement under the caption "Proposal No. 1—Election of Directors—Executive Compensation and Certain Transactions".

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The information required by Item 12 is incorporated by reference to the Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management".

Item 13. Certain Relationships and Related Transactions.

The information required by Item 13 is incorporated by reference to the Proxy Statement under the caption "Proposal No. 1—Election of Directors—Executive Compensation and Certain Transactions—Certain Transactions with Related Parties".

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

The following documents are filed as part of this report:

(a)(1) **Financial Statements:**

See Index on page F-1

(a)(2) **Financial Statement Schedules:**

See Index on page F-1

(a)(3) **Exhibits:**

- 3.1 —Restated Certificate of Incorporation (See Exhibit 3.1 to the Company's Form 10-K for the year ended December 31, 1985).
- 3.2 —Certificate of Amendment of Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on April 28, 1986. (See Exhibit 3.2 to the Company's Form 10-K for the year ended December 31, 1986)
- 3.3 —Certificate of Amendment of Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on May 22, 1987.
- 3.4 —Bylaws of the Company.
- 4. —Instruments defining the rights of security holders, including indentures. The Company hereby undertakes to furnish copies of any long-term debt instruments to the Securities and Exchange Commission (the "Commission") upon request.
- 10.1 —Executive Incentive Compensation Plan, as amended through October 18, 1979 (See Exhibit A(1) to the Company's Form 10-K for the year ended December 31, 1979), amendment thereto (See Exhibit 10.6 to the Company's Form 10-K for the year ended December 31, 1982).
- 10.2 —Plan for the Sale of Restricted and Unrestricted Common Stock to Employees Who Perform Executive, Administrative or Supervisory Functions (the "Restricted Stock Purchase Plan"), as amended through September 23, 1982 (See Exhibit 10.7 to the Company's Form 10-K for the year ended December 31, 1983).
- 10.3 —1975 Stock Option Plan (See Exhibit 10.9 to the Company's Form 10-K for the year ended December 31, 1982), amendment thereto (See Exhibit 10.09 to the Company's Form 10-K for the year ended December 31, 1982).
- 10.4 —Unanimous written consent of the Stock Option Committee, dated July 22, 1982, amending the Company's stock option agreements to include Limited Rights (See Exhibit 10.11 to the Company's Form 10-K for the year ended December 31, 1982).
- 10.5 —1984 Employee Stock Option Plan (See Exhibit 10.2 to the Company's Form 10-Q for the quarter ended April 1, 1984).
- 10.6 —Deferred Compensation Letter Agreement, dated December 11, 1985 (See Exhibit 10.7 to the Company's Form 10-K for the year ended December 31, 1985).
- 10.7 —Amendment to the Restricted Stock Purchase Plan, dated February 24, 1986 (See Exhibit 10.8 to the Company's Form 10-K for the year ended December 31, 1986).
- 10.8 —Letter Agreement, dated February 29, 1988, between the Company and the GAF Management Group (without exhibits). (See Exhibit (c)(28)(i) to the Company's Form 8-K dated February 29, 1988.)
- 10.9 —Consulting Agreement, dated as of December 1, 1984, between the Company and G.B. Energy systems, Inc. for the performance of services by Dr. J. E. Goldman. (See Exhibit 10.14 to the Company's Form 10-K for the year ended December 31, 1984.) This contract has been extended, on a month-to-month basis, upon the same terms and conditions.
- 11. —Computation of Earnings per Common Share for the Three Years ended December 31, 1987.
- 21.1 —The Company hereby undertakes to file with the Commission a definitive copy of its Proxy Statement for the 1988 Annual Meeting of Shareholders by April 29, 1988, or to provide the Commission with the information for the Part III items hereof under cover of Form 8 by such date.
- 22. —Subsidiaries of the Company.
- 24.1 —Consent of Arthur Andersen & Co., Independent Public Accountants, included at page F-22 of this Report.

(b) Reports on Form 8-K.

Two reports on Form 8-K were filed with the Securities and Exchange Commission during the last quarter of 1987.

The first one, dated October 20, 1987, reported that the management-led group headed by Samuel J. Heyman, Chairman and Chief Executive Officer of the Company, intended to reconsider its September 8th buyout proposal. It also reported the authorization by the Board of Directors of the Company for the repurchase of up to seven million shares of common stock of the Company.

The second one, dated December 14, 1987, reported that a revised proposal for the management-led buyout of the Company was received by the Company.

Reference is made to the description of the foregoing events appearing in response to "Item 1—Other Corporate Developments".

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GAF CORPORATION
(Registrant)

Date: March 24, 1988

By SAMUEL J. HEYMAN
(Samuel J. Heyman)
*Chairman of the Board
and Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>SAMUEL J. HEYMAN</u> (Samuel J. Heyman)	Chairman of the Board and Chief Executive Officer	March 24, 1988
<u>SALVATORE C. BELLINI</u> (Salvatore C. Bellini)	Vice President and Controller	March 24, 1988
<u>DANIEL T. CARROLL</u> (Daniel T. Carroll)	Director	March 24, 1988
<u>CARL R. ECKARDT</u> (Carl R. Eckardt)	Director and Executive Vice President	March 24, 1988
<u>JACOB F. GOLDMAN</u> (Jacob E. Goldman)	Director	March 24, 1988
<u>SANFORD KAPLAN</u> (Sanford Kaplan)	Director	March 24, 1988
<u>WILLIAM P. LYONS</u> (William P. Lyons)	Director	March 25, 1988
<u>SCOTT A. ROGERS, JR.</u> (Scott A. Rogers, Jr.)	Director	March 25, 1988
<u>JAMES T. SHERWIN</u> (James T. Sherwin)	Director and Vice Chairman	March 24, 1988
<u>WILLIAM SPIER</u> (William Spier)	Director	March 24, 1988
<u>JOSEPH D. TYDINGS</u> (Joseph D. Tydings)	Director	March 24, 1988

GAF CORPORATION
FORM 10-K

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CONSOLIDATED FINANCIAL STATEMENTS
AND SCHEDULES**

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GAF CORPORATION AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

Financial Condition

Record earnings before extraordinary credits of \$100.1 million in 1987 and \$80.7 million in 1986 enabled the Company to generate funds from operations before extraordinary credits of \$103.6 million in 1987 and \$100.5 million in 1986. Including extraordinary credits of \$137.5 million and \$212.5 million in 1987 and 1986, total funds from operations were \$241.2 million and \$313 million, respectively.

These results reflect record earnings by the Company's Chemicals business. Profits from the Building Materials business declined in 1987 due primarily to severe pricing pressure. Income on investments was \$97 million in 1987, up from \$77.9 million in 1986 and \$22.4 million in 1985. In 1987, the Company realized extraordinary after tax gains of \$97.1 million on its investment in Borg-Warner Corporation and \$39.5 million and \$201.4 million, respectively, in 1987 and 1986 on its investment in Union Carbide Corporation.

Pursuant to a stock repurchase program authorized by the Board of Directors in April 1987, the Company repurchased 2,121,469 shares at a cost of \$103.1 million. On October 20, 1987, the Company announced that its Board had authorized the repurchase of up to 7 million shares (approximately 21%) of the Company's common stock. The Company repurchased 5,857,200 shares at a total cost of \$219.9 million, an average cost per share of \$37.54, under this program.

As a result of the \$323 million outlay of funds for the repurchase programs, the Company's total assets, shareholders' equity, working capital, and total cash and short-term investments and marketable securities decreased in 1987, after increasing in 1986. Shareholders' Equity, which more than doubled in 1986 to \$601.5 million, fell \$93.2 million (15%) to \$508.3 million in 1987. Book value per share rose to \$18.34 at December 31, 1987, from \$16.94 the previous year due to fewer shares outstanding. Total assets, which increased \$467.9 million (53%) in 1986 to \$1.347 billion, declined by \$49.3 million (4%) in 1987.

Of the total assets at December 31, 1987 and 1986, \$615.1 million and \$864.8 million, respectively, consisted of cash, short-term investments and marketable securities. Total debt at December 31, 1987 and 1986 was \$502.1 million and \$483.2 million. Debt as a percent of debt plus equity was 49.7%, 44.5% and 55.7% as of year-end 1987, 1986 and 1985.

Total working capital decreased \$136.6 million (28%) in 1987 to \$355.6 million, mainly reflecting \$136.4 million lower total cash and short-term investments. The working capital ratio was 3.95:1 at December 31, 1986 and 2.58:1 at year-end 1987.

Other Assets increased from \$61.4 million to \$85.4 million, reflecting \$10.7 million of equity income from the Company's unconsolidated captive insurance company and the 50% ownership of GAF/Hüls Chemie GmbH and \$11.4 million of deferred charges. Other Liabilities fell to \$72.7 million from \$98.5 million last year as a result of settlement of certain liabilities.

In November 1987, the Company acquired Alkaril Chemicals Limited (Alkaril), a privately held Canadian-based manufacturer of surfactants and other specialty chemicals for \$70 million. Internal funds were utilized to finance this acquisition. The acquisition was accounted for by the purchase method of accounting, resulting in an excess of cost over net assets acquired of \$50.2 million (see Note 5 of Notes to Consolidated Financial Statements).

The Company invests in a variety of short-term domestic and foreign instruments, including preferred and common stock, fixed income and risk arbitrage securities, dividend capture and stock/futures arbitrage positions, commercial paper and repurchase agreements, selected to maximize income return. During

1987, the Company invested an average of approximately \$75 million of its cash in reverse repurchase agreements with various, reputable counterparties, for which management believes the Company is at minimal risk

Due to the decline in the stock market during the fourth quarter of 1987, the Company sustained realized and unrealized losses in its portfolio of investments. Investments are carried at the lower of cost or market, and net unrealized losses at December 31, 1987 of \$5.7 million on the aggregate portfolio of short-term investments are reflected in the Company's results for the year. Unrealized losses, net of tax, of \$22 million in connection with long-term equity investments are reflected as a reduction of shareholders' equity since management does not deem such losses to be permanent.

The Company's capital expenditures nearly doubled in 1987 to approximately \$66 million compared with \$34 million in 1986, with all the expenditures financed with internally generated funds. The higher capital outlays were principally for increased production capacity at domestic plants.

Results of Operations

1987 Versus 1986

GAF in 1987 recorded its fourth consecutive year of record earnings before extraordinary credits. Income before extraordinary credits of \$100.1 million (\$2.93 per share) was up 24% over 1986 income of \$80.7 million (\$2.22 per share). Income from the Chemicals business and GAF Broadcasting reached record levels, while Building Materials profits declined by 13%.

Net income for 1987 of \$237.6 million (\$6.96 per share) included \$137.5 million in extraordinary credits, primarily representing \$97.1 million in net gains from the second quarter 1987 tender of the Company's Borg-Warner shares and \$39.5 million in after tax gains relating to the Company's investment in Union Carbide. Net income for 1986 of \$293.2 million (\$8.07 per share) included \$201.4 million in extraordinary credits resulting from the Union Carbide investment and \$11.1 million in extraordinary tax credits.

Consolidated sales in 1987 of \$836.9 million were 11% higher than 1986 sales of \$753.8 million, reflecting increased unit sales for all of the Company's product lines, which more than offset the negative effects of lower Building Materials selling prices.

Consolidated operating income for 1987 of \$118.9 million increased 5% from last year's \$113.6 million. The gross profit margin, which was 34.2% in 1986, improved slightly to 34.3% in 1987 despite higher raw material costs and a \$5.1 million pretax charge (\$3.6 million after tax, or 11 cents per share) resulting from the adoption of the LIFO method of determining cost for a substantial portion of the Company's domestic inventories.

Chemicals reported another year of record profits of \$130 million in 1987, a 21% increase over the previous high of \$107.8 million last year. This marked the fifth consecutive year of record Chemicals profits. Chemicals sales rose to \$431.4 million, a gain of 14% over last year's \$377.5 million. This performance was due to several factors: significantly higher unit sales volumes in all product lines resulting from strong demand in all regions of the world; a favorable product mix; continued cost efficiency programs; and the continued decline in the U.S. dollar coupled with the increased international sales volumes attained through greater market penetration.

GAF Chemicals further expanded its surfactants business by the acquisition in November 1987 of Alkaril Chemicals Limited for \$70 million. Alkaril has production facilities in Mississauga, Ontario, Canada and Winder, Georgia. The results of this acquisition are included in Chemicals' results subsequent to the date of acquisition. This acquisition follows the 1986 purchase of the surfactants and phosphate esters businesses of Borg-Warner Corporation. These moves not only give GAF new technology, but also provide increased manufacturing capacity for surfactants at four dedicated facilities in North America.

Chemicals' return on sales of 30% was up from last year's figure of 29% and the 1985 figure of 25%. The operating return on assets declined to 31% in 1987 as compared with 43% last year due to the fact that the total assets of Alkaril Chemicals were included in identifiable assets, but corresponding earnings

were only included for the period after the November 10th acquisition date. Total identifiable assets increased by 67% to \$419.5 million as a result of the Alkaril acquisition and an aggressive capital expansion program. Spending for new and replacement facilities grew to \$34 million from \$13.4 million in 1986.

The Building Materials business recorded a profit of \$26 million in 1987 which was \$4 million (13%) below last year. The 1987 results reflect a charge of \$2.7 million related to the adoption of LIFO. Sales in 1987 increased \$28.4 million (8%) to \$400.5 million, reflecting increased unit sales of residential and commercial roofing products which more than offset the impact of a further decline in selling prices. The reduced profit was due to the continued erosion of selling prices, which was offset in part by increased unit sales volume, savings related to improved manufacturing efficiencies, and lower raw material costs earlier in the year. In addition, Building Materials benefited from a more favorable product mix with the continued sales growth of premium products as well as the addition of GAF Wood Line™, a new mid-weight laminated shingle introduced early in 1987.

Interest expense increased in 1987 to \$54.1 million from last year's \$35.4 million, reflecting debt service on the Company's senior subordinated notes and debentures which were issued in November 1986. The higher interest expense was more than offset by higher income from the Company's investment programs. Such income increased in 1987 to \$97 million from \$77.9 million in 1986 as detailed in Note 2 to Consolidated Financial Statements.

Other Expense—net in 1986 consisted primarily of expenses and reserves in connection with products no longer manufactured or sold by the Company, partially offset by \$8.4 million of equity income from the Company's unconsolidated captive insurance company and the 50% ownership of GAF/Hüls Chemie GmbH. Other Expense—net in 1987 reflects lower expenses and reserves related to discontinued products and higher equity income of \$10.7 million.

1986 Versus 1985

Income before extraordinary credits of \$80.7 million increased 49% over the previous high of \$54.3 million set in 1985. Income from the Chemicals business and GAF Broadcasting reached record levels, while the Building Materials business had its best year since 1978.

Net income for 1986 of \$293.2 million included \$201.4 million (\$5.55 per share) in extraordinary credits, after taxes and expenses, resulting from Union Carbide's January 1986 exchange offer, Carbide's special third quarter 1986 dividend and the sale of Carbide shares. In addition, there were \$11.1 million in extraordinary tax credits from the utilization of domestic and foreign operating loss carryforwards compared with the previous year's \$23.3 million.

Consolidated sales in 1986 of \$753.8 million were 3% higher than 1985 sales of \$732 million, reflecting increased unit sales for most of the Company's product lines, which more than offset the negative effects of lower domestic selling prices, primarily in residential roofing. For the three-year period ending in 1986, sales increased 8%. However, after adjusting consolidated sales for the sale or discontinuance of certain product lines, sales growth was 23%.

Consolidated operating income for 1986 of \$113.6 million increased 29% from the previous year's \$87.9 million. The gross profit margin, which was slightly under 30% in 1985, improved to 34% in 1986.

Chemicals reported record profits of \$107.8 million in 1986, a 16% increase over the previous high of \$92.6 million for the year 1985, due to: a marked improvement in unit sales in most product lines resulting from strong domestic and international demand; a favorable product mix; lower raw material prices; continued cost improvements primarily due to manufacturing efficiencies; and the improved profitability from international operations reflecting increased market penetration and the continued decline of the U.S. dollar. These factors more than offset the effect of lower selling prices in a year when pricing in some product lines was softer than the corresponding decreases in raw material prices. Chemicals sales grew to \$377.5 million from \$364.4 million.

Building Materials profits were \$30 million in 1986, up 49% from \$20.1 million in 1985 and the third consecutive year of earnings growth. Sales in 1986 were \$372.1 million, up from \$363.9 million in 1985, as an increase in residential and commercial roofing unit sales was partially offset by the continued erosion of selling prices. The improved profit performance resulted from continued cost control programs, manufacturing efficiencies, lower raw material prices, and a higher unit sales volume, which combined to more than offset the adverse effect of lower selling prices. Building Materials also benefited from a more favorable product mix as a result of new product introductions and increased sales emphasis on Timberline®, the Company's premium roofing product, and Royal Sovereign®, a residential shingle introduced in 1985.

Interest expense increased in 1986 to \$35.4 million from 1985's \$19.8 million, reflecting debt service on the Company's senior subordinated notes and debentures which were issued in June 1985 and November 1986. The higher interest expense was more than offset by higher income from the Company's investment programs. Such income increased in 1986 to \$77.9 million from \$22.4 million in 1985.

GAF CORPORATION AND SUBSIDIARIES

SELECTED FINANCIAL DATA

	Year ended December 31,				
	1987	1986	1985	1984	1983
(Dollars in Millions, Except Per Share Amounts)					
Sales					
Chemicals.....	\$ 431.4	\$ 377.5	\$364.4	\$357.2	\$323.2
Building Materials.....	400.5	372.1	363.9	370.8	373.2
Broadcasting.....	5.0	4.2	3.7	3.3	3.0
Net Sales.....	<u>\$ 836.9</u>	<u>\$ 753.8</u>	<u>\$732.0</u>	<u>\$731.3</u>	<u>\$699.4</u>
Income (Loss) From Operations					
Chemicals.....	\$ 130.0	\$ 107.8	\$ 92.6	\$ 79.0	\$ 64.6
Building Materials.....	26.0	30.0	20.1	10.9	(34.5)
Broadcasting.....	1.6	1.3	1.1	0.7	0.5
Total.....	<u>\$ 157.6</u>	<u>\$ 139.1</u>	<u>\$113.8</u>	<u>\$ 90.6</u>	<u>\$ 30.6</u>
Income (Loss) Before Extraordinary Credits.....	\$ 100.1	\$ 80.7	\$ 54.3	\$ 41.0	\$(29.2)
Per Common Share—					
Primary.....	2.93	2.22	1.57	1.31	(1.11)
Fully Diluted.....	2.93	2.22	1.50	1.15	(1.11)
Dividends Per Common Share.....	.10	.10	.10	.05	.025
As of December 31,					
Current Assets.....	\$ 580.4	\$ 659.1	\$428.7	\$254.9	\$220.9
Current Liabilities.....	224.8	166.9	251.6	114.2	127.7
Working Capital.....	355.6	492.2	177.1	140.7	93.2
Marketable Securities.....	299.0	412.4	202.2	—	—
Property, Plant and Equipment—net.....	276.6	208.4	194.1	159.1	164.5
Total Assets.....	1,297.8	1,347.1	879.2	452.3	414.3
Short-term Debt.....	8.6	2.8	115.4	6.5	30.7
Total Long-term Debt.....	493.5	480.4	259.0	82.8	88.8
Shareholders' Equity.....	508.3	601.5	298.2	214.0	169.8
Percent of Debt to Debt Plus Equity.....	49.7%	44.5%	55.7%	29.4%	41.3%

GAF CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Thousands, Except Per Share Amounts)		
Net Sales	\$836,928	\$753,774	\$731,962
Costs and Expenses:			
Cost of Products Sold	549,501	496,184	513,813
Selling, General and Administrative	168,572	143,943	130,206
Total Costs and Expenses	718,073	640,127	644,019
Operating Income	118,855	113,647	87,943
Income on Investments	97,012	77,930	22,438
Interest Expense	(54,116)	(35,437)	(19,799)
Other Expense—net	(7,245)	(30,664)	(3,108)
Income Before Income Taxes and Extraordinary Credits	154,506	125,476	87,474
Income Taxes	54,454	44,790	33,178
Income Before Extraordinary Credits	100,052	80,686	54,296
Extraordinary Credits	137,505	212,475	23,285
Net Income	\$237,557	\$293,161	\$ 77,581
Earnings Per Common Share			
Primary:			
Before Extraordinary Credits	\$2.93	\$2.22	\$1.57
Extraordinary Credits	4.03	5.86	.68
Net Income	\$6.96	\$8.08	\$2.25
Fully Diluted:			
Before Extraordinary Credits	\$2.93	\$2.22	\$1.50
Extraordinary Credits	4.03	5.85	.65
Net Income	\$6.96	\$8.07	\$2.15

See Notes to Consolidated Financial Statements.

GAF CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31,	
	1987	1986
	(Dollars in Thousands)	
ASSETS		
Current Assets		
Cash	\$ 61,094	\$ 44,623
Short-term investments	254,984	407,840
Accounts receivable, less reserve: 1987—\$4,110; 1986—\$4,382	137,565	112,681
Inventories	116,304	86,190
Other current assets	10,509	7,787
Total Current Assets	580,456	659,121
Marketable Securities	298,978	412,365
Property, Plant and Equipment—net	276,620	208,396
Excess of Cost Over Net Assets of Businesses Acquired	56,289	5,744
Other Assets	85,428	61,443
Total Assets	<u>\$1,297,771</u>	<u>\$1,347,069</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term debt	\$ 8,585	\$ 2,757
Current maturities of long-term debt	1,559	335
Accounts payable	86,907	78,764
Accrued liabilities	96,308	79,289
Income taxes	31,471	5,805
Total Current Liabilities	224,830	166,950
Long-term Debt Less Current Maturities	491,966	480,114
Other Liabilities	72,658	98,507
Shareholders' Equity		
Preferred stock, \$1 par value per share: authorized 6,000,000 shares	—	—
Common stock, \$1 par value per share: authorized 100,000,000 shares; issued shares: 1987 and 1986—36,008,177	36,008	36,008
Additional paid-in capital	46,565	44,736
Retained earnings	753,438	519,207
Accumulated translation adjustment	18,134	3,928
Net unrealized loss on marketable equity securities	(22,038)	—
Treasury stock, at cost	(323,790)	(2,381)
Shareholders' Equity	508,317	601,498
Total Liabilities and Shareholders' Equity	<u>\$1,297,771</u>	<u>\$1,347,069</u>

See Notes to Consolidated Financial Statements.

GAF CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Thousands)		
Cash and Short-term Investments, January 1	\$452,463	\$217,160	\$ 69,553
Source (Use) of Funds:			
Income Before Extraordinary Credits	100,052	80,686	54,296
Charges (credits) not affecting funds:			
Depreciation	17,706	17,982	17,366
Other—net	(14,112)	1,814	5,308
Total funds from operations before extraordinary credits	103,646	100,482	76,970
Extraordinary Credits	137,505	212,475	23,285
Total funds from operations	241,151	312,957	100,255
Additions to property, plant and equipment	(65,911)	(33,914)	(47,161)
Acquisition of Alkaril Chemicals Limited, net of cash acquired**	(67,449)	—	—
Acquisition of glass fiber facilities	—	—	(9,250)
Other working capital items*	(1,230)	42,633	2,492
Other	(21,792)	14,813	16,149
Total source before financing and investment activity	84,769	336,489	62,485
Financing and investment activity:			
Increase (decrease) in short-term debt	4,865	(112,623)	108,919
Increase in long-term debt	6,126	292,569	195,800
Decrease in long-term debt	(575)	(71,105)	(19,571)
Investment in marketable securities, net	113,387	(210,136)	(202,229)
Net unrealized loss on marketable equity securities	(22,038)	—	—
Stock repurchase programs	(322,997)	—	—
Cash dividends	(3,326)	(3,540)	(4,118)
Other	3,404	3,649	6,321
Total source (use) from financing and investment activity	(221,154)	(101,186)	85,122
Increase (decrease) in cash and short-term investments	(136,385)	235,303	147,607
Cash and Short-term Investments, December 31	\$316,078	\$452,463	\$217,160
* Other working capital items:			
Accounts receivable	\$(16,207)	\$ (3,101)	\$(14,441)
Inventories	(24,780)	7,817	(10,555)
Other current assets	(2,526)	179	(1,208)
Accounts payable	5,222	21,353	(457)
Accrued liabilities	15,727	20,365	22,362
Income taxes	21,334	(3,980)	6,791
Net source (use) of funds	\$ (1,230)	\$ 42,633	\$ 2,492
**Acquisition of Alkaril Chemicals Limited:			
Working capital other than cash acquired	\$ 4,399		
Property, plant and equipment	20,128		
Excess of cost over net assets	50,198		
Long-term debt	(6,935)		
Other liabilities	(341)		
Cash paid for acquisition	\$ 67,449		

See Notes to Consolidated Financial Statements.

GAF CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Thousands)		
\$1.20 Convertible Preferred Stock:			
Balance, January 1	\$ —	\$ —	\$ 3,175
Converted into common stock—2,428,625 shares	—	—	(3,036)
Redemption of preferred stock—111,033 shares	—	—	(139)
Balance, December 31	—	—	—
Common Stock, \$1 Par Value Per Share:			
Balance, January 1	36,008	17,878	14,509
Effect of 2 for 1 stock split	—	17,878	—
Other activity	—	252	3,369
Balance, December 31	36,008	36,008	17,878
Additional Paid-in Capital:			
Balance, January 1	44,736	60,836	56,420
Effect of 2 for 1 stock split	—	(17,878)	—
Conversion of 5% convertible subordinated notes	—	—	7,167
Redemption of preferred stock	—	—	(2,888)
Proceeds in excess of cost of treasury shares issued under stock plans ...	1,562	1,137	13
Other activity	267	641	124
Balance, December 31	46,565	44,736	60,836
Retained Earnings:			
Balance, January 1	519,207	229,586	156,123
Net Income	237,557	293,161	77,581
Cash dividends:			
Preferred stock (per share: 1985—\$.30)	—	—	(748)
Common stock (per share: \$.10)	(3,326)	(3,540)	(3,370)
Balance, December 31	753,438	519,207	229,586
Accumulated Translation Adjustment:			
Balance, January 1	3,928	(6,135)	(10,451)
Translation adjustment for the year	14,206	10,063	4,316
Balance, December 31	18,134	3,928	(6,135)
Net Unrealized Loss on Marketable Equity Securities:			
Balance, January 1	—	—	—
Valuation adjustment for the year	(22,038)	—	—
Balance, December 31	(22,038)	—	—
Treasury Stock, at cost:			
Common stock:			
Balance, January 1	(2,381)	(4,012)	(4,113)
Shares repurchased—7,978,669 shares	(322,997)	—	—
Issued under various stock option and stock purchase plans: 1987—185,319 shares; 1986—219,362 shares; 1985—198,424 shares	1,588	1,890	1,758
Other activity	—	(259)	(1,657)
Balance, December 31: 1987—8,294,574 shares; 1986—500,145 shares; 1985—453,640 shares	(323,790)	(2,381)	(4,012)
Shareholders' Equity	\$ 508,317	\$601,498	\$298,153

See Notes to Consolidated Financial Statements.

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Summary of Significant Accounting Policies

Principles of Consolidation

The accounts of all significant subsidiaries of the Company are included in the consolidated financial statements. All significant intercompany transactions and balances have been eliminated. A wholly owned captive insurance subsidiary and the 50% ownership of a foreign chemical manufacturing company are accounted for by the equity method.

Short-term Investments and Marketable Securities

Short-term investments and marketable securities are stated at the lower of cost or market. The determination of cost in computing realized gains and losses on investments is based on the specific identification method.

Inventories

Inventories are stated at the lower of cost or market. In the fourth quarter of 1987, the Company adopted the LIFO (last-in, first-out) method of determining cost for a substantial portion of its domestic inventories. All other inventories are based principally on average cost.

Property, Plant and Equipment and Related Depreciation

Depreciation is computed principally on the straight-line method based on the estimated economic lives of the assets. Certain interest charges are capitalized as part of the cost of property, plant and equipment additions.

Deferred Income Taxes

Deferred income taxes arise from reporting certain income and expense items in the financial statements in periods different from those in which such amounts are reported for income tax purposes.

Excess of Cost Over Net Assets of Businesses Acquired

Excess of cost over net assets of businesses acquired in connection with acquisitions prior to November 1, 1970, is not being amortized because there has been no diminution in value; such cost relating to the November 1987 acquisition of Alkaril Chemicals Limited (see Note 5) is being amortized on the straight-line method over a period of forty years.

Research and Development

Research and development expenses are charged to operations as incurred and amounted to \$12.2 million in 1987, \$11.4 million in 1986 and \$10.4 million in 1985.

Earnings Per Common Share

Primary earnings per common share are based on the weighted average number of common and common equivalent shares outstanding during each year after giving appropriate effect to preferred stock dividends, where applicable. Weighted average shares for computing primary earnings per share were (in thousands) 34,144 for 1987, 36,283 for 1986 and 34,342 for 1985.

Fully diluted earnings per share are based on the weighted average number of common and common equivalent shares outstanding and the assumed conversion of convertible securities outstanding after

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 1. Summary of Significant Accounting Policies—(Continued)

appropriate adjustment for interest on convertible notes, where applicable. Weighted average shares for computing fully diluted earnings per share were (in thousands) 34,144 for 1987, 36,318 for 1986 and 36,094 for 1985.

NOTE 2. Short-term Investments and Marketable Securities

In March 1987, the Company purchased 9.1 million additional common shares of Borg-Warner Corporation for \$365.6 million, bringing the total holdings in Borg-Warner to 17.1 million shares, or 19.9% of the total shares outstanding. The Company announced on March 31, 1987 that it had made an all-cash merger proposal to Borg-Warner at \$46 per share (later increased to \$48 per share), for all of that company's outstanding shares. On April 10, Borg-Warner announced that it had entered into an agreement with a Merrill Lynch affiliate endorsing a merger offer of \$48.50 per share. On April 27, the Company announced that it had decided to withdraw its offer and then tendered 16.4 million Borg-Warner shares into the Merrill Lynch tender offer. The remaining shares were exchanged in the third quarter for cash and bonds. The Company has thus far realized total pretax profits (after expenses) of \$205.6 million from its investment in Borg-Warner, which includes a pretax extraordinary credit (after expenses) of \$157.2 million (\$97.1 million after tax) as a result of the sale of the 16.4 million shares.

During 1985, the Company acquired approximately 10% of the total outstanding shares of Union Carbide Corporation and, in December 1985, announced its intention to commence a cash tender offer for all the remaining outstanding shares. However, the Company withdrew its tender offer in January 1986, and received \$70 million in cash and \$227.5 million in Carbide bonds in exchange for 3.5 million of the Carbide shares it owned. The Company received net proceeds from the sale of Carbide bonds in 1986 of approximately \$245 million, resulting in a net realized gain of \$17.5 million, which is included in 1986 income on investments. Extraordinary credits for 1987 and 1986, respectively, include net gains of \$39.5 million and \$201.4 million, after taxes and expenses, resulting from the Carbide exchange offer in January 1986, Carbide's special third quarter 1986 dividend and the sale of Carbide shares during 1986 and 1987.

The Company invests in a variety of short-term domestic and foreign instruments, including preferred and common stock, fixed income and risk arbitrage securities, dividend capture and stock/futures arbitrage positions, commercial paper and repurchase agreements, selected to maximize income return. The average amount invested in short-term investments during 1987 was approximately \$647 million. At December 31, 1987, the aggregate cost of the Company's short-term investments was \$260.7 million while the aggregate market value was \$255 million.

As of December 31, 1987, the Company held positions in several publicly-owned companies. These investments, classified as marketable securities, had an aggregate cost of \$332.4 million at December 31, 1987, while the aggregate market value was \$299 million. The unrealized loss in market value of the equity securities is reflected on an after tax basis as a reduction of shareholders' equity since management does not deem such unrealized losses to be permanent.

Income on Investments consists of the following:

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Millions)		
Net realized gains, net of unrealized losses on short-term investments	\$31.6	\$42.4	\$ 8.9
Dividends, interest income and other	65.4	35.5	13.5
	<u>\$97.0</u>	<u>\$77.9</u>	<u>\$22.4</u>

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS— (Continued)

NOTE 3. Inventories

In the fourth quarter of 1987, the Company adopted the LIFO method of determining cost for a substantial portion of its domestic inventories. The effect of the change in 1987 was to reduce inventories and pretax income by \$5.1 million (\$3.6 million after tax, or 11 cents per share). Inventories stated under the LIFO method represent approximately 47% of domestic inventories and 37% of total consolidated inventories.

Inventories at December 31 consist of the following:

	<u>1987</u>	<u>1986</u>
	(Dollars in Thousands)	
Finished goods	\$ 73,276	\$47,315
Work in process	17,837	15,640
Raw materials and supplies	30,335	23,235
Total	<u>121,448</u>	<u>86,190</u>
Less LIFO Reserve	(5,144)	—
Inventories	<u>\$116,304</u>	<u>\$86,190</u>

NOTE 4. Property, Plant and Equipment

Property, Plant and Equipment at December 31 consist of the following:

	<u>1987</u>	<u>1986</u>
	(Dollars in Thousands)	
Land and land improvements	\$ 19,224	\$ 16,403
Buildings and building equipment	66,617	56,814
Machinery and equipment	271,954	240,174
Construction in progress	47,158	16,197
Total	<u>404,953</u>	<u>329,588</u>
Less Accumulated Depreciation	(128,333)	(121,192)
Property, Plant and Equipment—net	<u>\$ 276,620</u>	<u>\$ 208,396</u>

NOTE 5. Acquisition of Alkaril Chemicals Limited

In November 1987, the Company acquired Alkaril Chemicals Limited (Alkaril), a privately held Canadian-based manufacturer of surfactants and other specialty chemicals with production facilities in Mississauga, Ontario, Canada and Winder, Georgia. The cost of the acquisition was \$70 million (\$67.4 million, net of cash acquired). The acquisition was accounted for by the purchase method of accounting, and accordingly, the acquired assets and liabilities have been recorded at their estimated fair values at the date of acquisition. The excess of cost over net assets acquired of \$50.2 million is being amortized on a straight-line basis over a period of 40 years.

The results of Alkaril are included in the Consolidated Statements of Income from the date of acquisition. The effect of the acquisition was not material to consolidated operations.

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 6. Income Taxes

Income Taxes consist of the following:

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Thousands)		
Federal.....	\$32,236	\$28,321	\$19,684
Foreign	19,420	12,521	7,882
State and local.....	2,798	3,948	5,612
	<u>\$54,454</u>	<u>\$44,790</u>	<u>\$33,178</u>

The differences between the income tax provisions computed by applying the statutory federal income tax rate to pretax income and the actual tax provisions are as follows:

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Thousands)		
Statutory Provisions	\$61,802	\$57,719	\$40,238
Adjustments			
Dividend received deductions.....	(7,085)	(7,267)	(1,650)
Capital gains differential.....	(1,338)	(8,926)	(1,987)
Investment tax credits	—	(2,625)	(3,217)
Impact of foreign operations.....	609	2,042	(1,581)
State and local taxes.....	1,679	2,132	3,031
Other	(1,213)	1,715	(1,656)
	<u>\$54,454</u>	<u>\$44,790</u>	<u>\$33,178</u>

As of December 31, 1987, provision had not been made for United States income taxes on approximately \$38 million of unremitted earnings of consolidated foreign subsidiaries and the Company's 50% owned joint venture, because certain of such unremitted earnings will be indefinitely reinvested and any United States taxes payable on foreign earnings which may be remitted in the future are expected to be substantially reduced by foreign tax credits.

Extraordinary credits for 1987, 1986 and 1985 include \$966,000, \$1,333,000 and \$1,576,000, respectively, representing the income tax benefit from the utilization of foreign operating loss carryforwards. The 1986 and 1985 extraordinary credits also include income tax benefits of \$9,764,000 and \$21,709,000 from the utilization of federal and state operating loss carryforwards. The 1987 and 1986 extraordinary credits also include income tax benefits of \$22,400,000 and \$19,462,000 related to the Company's partial disposition of its investment in Union Carbide Corporation (see Note 2).

In the fourth quarter of 1987, the Financial Accounting Standards Board issued Statement No. 96, "Accounting for Income Taxes". The Company is required to adopt the new accounting and disclosure rules no later than 1989 although earlier implementation is permitted. No decision has been made as to the date of implementation. Implementation of the new Statement is not expected to have a material impact on the Company's consolidated financial position.

NOTE 7. Benefit Plans

The GAF Capital Accumulation Plan is a defined contribution plan for eligible salaried employees. Company contributions consist of a basic contribution of three percent of the compensation of participants for the plan year together with matching contributions, up to an additional four percent as specified in the

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS— (Continued)

NOTE 7. Benefit Plans— (Continued)

plan, for those participants who have elected to make voluntary contributions to the plan. Each participant is fully vested at all times in the balance of each of his or her accounts in the plan. The aggregate contributions made by the Company to the plan and charged to operations in 1987, 1986 and 1985 were \$3,755,000, \$3,385,000 and \$3,126,000, respectively.

The retirement plans for hourly employees and Texas City facility employees are noncontributory defined benefit plans. Benefits for these plans are based on stated amounts for years of service. The Company's funding policy is consistent with the minimum funding requirements of ERISA, plus any additional amounts which the Company may determine to be appropriate. Pension expense charged to operations was \$1,087,000 in 1987, \$870,000 in 1986 and \$559,000 in 1985.

Net periodic pension cost for 1987 included the following components (dollars in thousands):

Service cost.....	\$ 770
Interest cost.....	407
Actual return on plan assets.....	10
Net amortization and deferral.....	(100)
Net periodic pension cost.....	<u>\$1,087</u>

The following table sets forth the funded status of the retirement plans for hourly employees and Texas City facility employees at December 31, 1987 (dollars in thousands):

Accumulated benefit obligation:	
Vested.....	\$5,377
Nonvested.....	742
Total accumulated benefit obligation.....	<u>\$6,119</u>
Projected benefit obligation.....	\$6,119
Fair value of plan assets, primarily listed stocks and U.S. Government securities.....	(2,403)
Projected benefit obligation in excess of plan assets.....	3,716
Unrecognized net transition obligation being recognized over 15 years.....	(770)
Unrecognized prior service cost.....	(356)
Unrecognized net gain.....	252
Unfunded accrued pension cost.....	<u>\$2,842</u>

The above tables reflect the provisions of Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions", which the Company adopted effective January 1, 1987. In determining the projected benefit obligation, the weighted average assumed discount rate was 9%, while the expected long-term rate of return on assets, used in determining net periodic pension cost, was 8%.

The Company has a deferred compensation plan for the benefit of key employees. The benefit payable under the plan, which accrues in accordance with a ten-year schedule, consists of an annual payment commencing at age 65 equal to 25% of a covered employee's last full year's salary. If a covered employee dies while employed by the Company, a death benefit of 36% of the employee's annual income at the date of death is payable to the employee's beneficiary for a term of 15 years. Employees who participate in this plan are not entitled to have employer contributions made to their accounts under the GAF Capital Accumulation Plan. The expense charged to operations in 1987 and 1986 for such future obligations amounted to \$673,000 and \$995,000, respectively.

In addition to providing pension benefits, the Company and its subsidiaries provide certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees, including employees in foreign countries, may become eligible for those benefits if they reach normal

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 7. Benefit Plans—(Continued)

retirement age while working for the Company. The cost of retiree health care and life insurance benefits (\$3.0 million, \$3.0 million and \$3.2 million in 1987, 1986 and 1985, respectively) is recognized as expense as claims are incurred.

As part of the 1977 and 1980 discontinuance programs, the Company provided health and life insurance coverage for certain retired employees of discontinued businesses. The balance of the liability for such future obligations at December 31, 1987 was \$13 million.

NOTE 8. Debt and Dividend Restrictions

Information regarding short-term debt is as follows:

	<u>1987</u>	<u>1986</u>	<u>1985</u>
	(Dollars in Thousands)		
As of December 31:			
Balance outstanding.....	\$ 8,585	\$ 2,757	\$115,380
Weighted average interest rate.....	9.4%	6.2%	8.7%
For the Year:			
Average month-end short-term debt outstanding.....	\$ 33,115	\$ 95,828	\$ 51,757
Maximum month-end short-term debt outstanding.....	\$171,426	\$185,559	\$118,315
Weighted average month-end interest rate.....	6%	7%	8.6%

At December 31, 1987, the Company had unused short-term lines of credit aggregating approximately \$135 million (in addition to the revolving credit facility discussed below). The short-term lines of credit are maintained with banks on terms which expire on various dates, but are generally renewable. Borrowings generally bear interest at or near the prime commercial lending rate.

Long-term debt at December 31, 1987 and 1986 was as follows:

	<u>1987</u>	<u>1986</u>
	(Dollars in Thousands)	
Industrial revenue bonds with various interest rates and maturity dates to 2012. Certain assets are pledged as collateral thereto.....	\$ 36,976	\$ 37,426
Obligations on mortgaged properties.....	47,588	38,125
11½% senior subordinated notes due June 15, 1995.....	150,000	150,000
10½% senior subordinated notes due November 1, 1994.....	155,000	155,000
10½% senior subordinated debentures due November 1, 2001.....	105,000	105,000
Other.....	4,227	454
Less unamortized discount.....	(5,266)	(5,556)
Total.....	493,525	480,449
Less current maturities.....	(1,559)	(335)
Long-term Debt Less Current Maturities.....	<u>\$491,966</u>	<u>\$480,114</u>

The Company has a \$75 million revolving credit agreement with a consortium of ten banks, terminating June 30, 1990. Interest on borrowings is, at the option of the Company, at the prime rate, a rate based on the London Interbank Offer Rate, or a rate based on the Certificate of Deposit Rate. Under the agreement, a commitment fee of ¼% per annum is charged on the daily average unused portion of the commitments. The agreement includes certain restrictions on dividends and provisions for the maintenance of minimum working capital, net worth and limitations on debt. There were no borrowings outstanding under this agreement at December 31, 1987 and 1986. As of December 31, 1987, \$60 million of retained earnings were available under this agreement for cash dividends and certain other special payments.

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS— (Continued)

NOTE 8. Debt and Dividend Restrictions— (Continued)

The Company in June 1985 issued \$150 million of 11½% senior subordinated notes due June 15, 1995. The notes will be redeemable at the option of the Company on and after June 15, 1992.

In October 1986, the Company placed a \$38.1 million mortgage on the Company's headquarters property. The mortgage is due on October 8, 1996, and interest is a rate based on the London Interbank Offer Rate.

In November 1986, the Company issued \$155 million of 10½% senior subordinated notes due 1994 and \$105 million of 10½% senior subordinated debentures due 2001. The notes will be redeemable at any time, at the option of the Company, after October 31, 1991, while the debentures will be redeemable at any time, at the option of the Company, after October 31, 1995. Annual sinking fund payments of 18.75% of the principal amount of the debentures originally issued, commencing November 1, 1997, are calculated to retire 75% of the principal amount of the debentures prior to maturity. The securities are subordinated to all existing and future senior indebtedness of the Company.

The aggregate maturities of long-term debt for the next five years are as follows (dollars in thousands):

1988.....	\$1,559
1989.....	4,945
1990.....	797
1991.....	756
1992.....	6,902

NOTE 9. Capital Stock

During 1987, pursuant to authorizations from its Board of Directors, the Company repurchased 7,978,669 shares of the Company's common stock at a total cost of \$323 million.

At December 31, 1987, there were 3,432,579 shares of common stock reserved for issuance under the Company's stock option and stock purchase plans.

NOTE 10. Stock Option and Stock Purchase Plans

The Company's 1984 Stock Option Plan provides for the granting of incentive and nonqualified stock options to key employees of the Company and its subsidiaries to purchase common stock of the Company at not less than 100% of the fair market value at the date of grant. Under the terms of the plan, options for 1,600,000 shares of common stock may be granted from time to time until April 30, 1989. The term of each option is five years and sixty days. Options may not be exercised during the first year after the date of grant, but thereafter, options become exercisable as to 20% of the shares subject thereto on each of the first through the fifth anniversaries of the date of grant.

The Company's 1975 nonqualified stock option plan provided for the granting of 1,600,000 options to key employees to purchase common stock of the Company at not less than 100% of the fair market value at the date of grant. Options granted through April 30, 1984 were exercisable one year after grant and expire after 10 years. Options granted after April 30, 1984 are subject to the same terms and conditions as options issued under the 1984 Stock Option Plan. The 1975 plan terminated in 1985, and no additional options have been granted after that date.

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 10. Stock Option and Stock Purchase Plans—(Continued)

The plans provide for limited stock appreciation rights permitting the option holder to surrender exercisable options in the event of a tender or exchange offer for the Company's common stock made by someone other than the Company.

The following is a summary of certain information pertaining to the 1975 and 1984 stock option plans:

	<u>1987</u>	<u>1986</u>	<u>1985</u>
	(Number of Shares)		
Outstanding January 1	1,424,762	1,344,200	1,351,600
Granted	275,350	277,600	184,010
Exercised	(135,253)	(109,068)	(116,370)
Terminated	(49,002)	(87,970)	(75,040)
Outstanding December 31	<u>1,515,857</u>	<u>1,424,762</u>	<u>1,344,200</u>
At December 31:			
Exercisable	650,345	547,290	461,790
Available for grant	369,772	596,480	787,190
	(Option Price Range Per Share)		
Outstanding	\$ 4.81-	\$ 4.81-	\$ 4.81-
	\$53.63	\$38.50	\$23.13
Exercised	\$ 4.81-	\$ 4.81-	\$ 4.81-
	\$35.81	\$23.13	\$11.88

The Company's 1984 Employee Stock Purchase Plan provides for grants of options to purchase 1,200,000 shares of common stock on a nondiscriminatory basis to all eligible employees of the Company and its subsidiaries. No options to purchase shares of common stock under the plan may be granted after April 30, 1989. The price at which shares may be purchased is the lesser of (i) 85% of the fair market value on the date of grant or (ii) 85% of the fair market value on the date of purchase. As of December 31, 1987, 223,888 shares of common stock had been issued under the plan.

Under the provisions of the Company's 1969 Restricted and Unrestricted Stock Purchase Plan, 1,300,000 shares of common stock were authorized for sale to key employees. The plan currently provides that restricted and unrestricted shares may be sold at prices which are not less than 50% and 80%, respectively, of the closing market price preceding the date of grant. To date, only restricted shares have been offered for sale. Under certain conditions, the Company has the right to repurchase restricted shares of common stock at the original selling price. At December 31, 1987, there were 570,838 shares available for sale under this stock purchase plan.

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS— (Continued)

NOTE 11. Business Segments Information

	Year Ended December 31,		
	<u>1987</u>	<u>1986</u>	<u>1985</u>
	(Dollars in Millions)		
Sales:			
Chemicals*	\$ 431.4	\$ 377.5	\$364.4
Building Materials	400.5	372.1	363.9
Broadcasting	5.0	4.2	3.7
Net Sales	<u>\$ 836.9</u>	<u>\$ 753.8</u>	<u>\$732.0</u>
Income From Operations			
Chemicals**	\$ 130.0	\$ 107.8	\$ 92.6
Building Materials	26.0	30.0	20.1
Broadcasting	1.6	1.3	1.1
Total	<u>157.6</u>	<u>139.1</u>	<u>113.8</u>
Corporate:			
Operating Expenses	(17.8)	(16.1)	(15.4)
Interest Expense	(54.1)	(35.4)	(19.8)
Other Income—net	68.8	37.9	8.9
Net Corporate Expenses	<u>(3.1)</u>	<u>(13.6)</u>	<u>(26.3)</u>
Income Before Income Taxes and Extraordinary Credits	<u>\$ 154.5</u>	<u>\$ 125.5</u>	<u>\$ 87.5</u>
Identifiable Assets:			
Chemicals**	\$ 419.5	\$ 251.8	\$217.3
Building Materials	229.1	194.0	194.2
Corporate and other	649.2	901.3	467.7
Total Assets	<u>\$1,297.8</u>	<u>\$1,347.1</u>	<u>\$879.2</u>
Additions to Property, Plant and Equipment:			
Chemicals	\$ 34.0	\$ 13.4	\$ 21.5
Building Materials	30.5	20.3	24.4
Corporate and other	1.4	0.2	1.3
Total	<u>\$ 65.9</u>	<u>\$ 33.9</u>	<u>\$ 47.2</u>
Depreciation:			
Chemicals	\$ 8.1	\$ 9.6	\$ 10.3
Building Materials	8.7	7.5	6.0
Corporate and other	0.9	0.9	1.1
Total	<u>\$ 17.7</u>	<u>\$ 18.0</u>	<u>\$ 17.4</u>

* Chemicals sales are net of intersegment sales of \$31.5 million, \$29.1 million and \$27.4 million, respectively. Intersegment sales are recorded at the same prices charged to unaffiliated customers.

** Chemicals income and identifiable assets include the Company's 50% equity in the income and assets of GAF/Hüls Chemie GmbH, a joint venture between GAF Corporation and Hüls A.G., which operates a chemical manufacturing plant in West Germany.

GAF CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS— (Continued)

NOTE 12. Geographic Information

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Millions)		
Domestic Operations:			
Net Sales*	\$ 682.0	\$ 638.8	\$ 642.9
Operating Income	\$ 83.3	\$ 90.5	\$ 73.3
Other Income (Expense)	21.8	8.8	(7.3)
Income Before Income Taxes and Extraordinary Credits	\$ 105.1	\$ 99.3	\$ 66.0
Identifiable Assets	\$1,094.7	\$1,255.1	\$ 826.6
Foreign Operations:			
Net Sales**	\$ 154.9	\$ 115.0	\$ 89.1
Operating Income	\$ 35.6	\$ 23.2	\$ 14.6
Other Income***	13.8	3.0	6.9
Income Before Income Taxes and Extraordinary Credits	\$ 49.4	\$ 26.2	\$ 21.5
Identifiable Assets***	\$ 203.1	\$ 92.0	\$ 52.6

* Domestic sales are net of transfers between geographic areas of \$68.3 million, \$46.6 million and \$40.8 million, respectively.

** Foreign sales are net of transfers between geographic areas of \$11.8 million, \$7.7 million and \$10.4 million, respectively.

*** Foreign Operations income and identifiable assets include the Company's 50% equity in the income and assets of GAF/Hüls Chemie GmbH.

NOTE 13. Commitments and Contingencies

The Company has operating leases for transportation, production and data processing equipment and for various buildings. Future minimum lease payments for properties which are held under long-term noncancellable leases as of December 31, 1987 are as follows (dollars in thousands):

1988.....	\$ 5,279
1989.....	2,961
1990.....	2,513
1991.....	2,181
1992.....	1,321
Later years	377
Total minimum payments	<u>\$14,632</u>

The discussion as to asbestos-related and environmental lawsuits involving the Company, and appearing in response to "Item 3—Legal Proceedings," is incorporated herein by reference.

NOTE 14. Supplementary Income Statement Information

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Thousands)		
Maintenance and repairs.....	\$49,610	\$45,774	\$41,068
Rentals—operating leases	7,451	6,789	6,296

NOTE 15. Proposed Merger

The discussion as to the proposed merger involving the Company, and appearing in response to "Item 1—Other Corporate Developments," is incorporated herein by reference.

GAF CORPORATION AND SUBSIDIARIES

SUPPLEMENTARY DATA (UNAUDITED)

Quarterly Financial Data (Unaudited)

	1987 By Quarter*				1986 By Quarter			
	First	Second	Third	Fourth	First	Second	Third	Fourth
(Dollars in Millions, Except Per Share Amounts)								
Net Sales	\$191.1	\$214.2	\$222.5	\$209.1	\$176.0	\$198.3	\$197.2	\$182.3
Cost of Products Sold	124.6	138.2	145.9	140.8	122.1	130.6	127.1	116.4
Gross Profit	<u>\$ 66.5</u>	<u>\$ 76.0</u>	<u>\$ 76.6</u>	<u>\$ 68.3</u>	<u>\$ 53.9</u>	<u>\$ 67.7</u>	<u>\$ 70.1</u>	<u>\$ 65.9</u>
Income Before Income Taxes and Extraordinary Credits	\$ 32.8	\$ 46.7	\$ 46.8	\$ 28.2	\$ 23.3	\$ 35.5	\$ 37.5	\$ 29.2
Income Taxes	12.2	17.0	16.5	8.7	8.3	13.3	13.0	10.2
Income Before Extraordinary Credits	20.6	29.7	30.3	19.5	15.0	22.2	24.5	19.0
Extraordinary Credits**	21.1	102.7	11.8	1.9	85.8	3.7	92.5	30.5
Net Income	<u>\$ 41.7</u>	<u>\$132.4</u>	<u>\$ 42.1</u>	<u>\$ 21.4</u>	<u>\$100.8</u>	<u>\$ 25.9</u>	<u>\$117.0</u>	<u>\$ 49.5</u>
Earnings Per Common Share***								
Primary:								
Before Extraordinary Credits	\$.56	\$.83	\$.88	\$.65	\$.41	\$.61	\$.67	\$.52
Extraordinary Credits .....	.58	2.89	.34	.06	2.37	.10	2.55	.84
Net Income	<u>\$ 1.14</u>	<u>\$ 3.72</u>	<u>\$ 1.22</u>	<u>\$.71</u>	<u>\$ 2.78</u>	<u>\$.71</u>	<u>\$ 3.22</u>	<u>\$ 1.36</u>
Fully Diluted:								
Before Extraordinary Credits	\$.56	\$.83	\$.88	\$.65	\$.41	\$.61	\$.67	\$.52
Extraordinary Credits .....	.58	2.88	.34	.06	2.37	.10	2.55	.84
Net Income	<u>\$ 1.14</u>	<u>\$ 3.71</u>	<u>\$ 1.22</u>	<u>\$.71</u>	<u>\$ 2.78</u>	<u>\$.71</u>	<u>\$ 3.22</u>	<u>\$ 1.36</u>

* In the fourth quarter of 1987, the Company adopted the LIFO method of determining cost for a substantial portion of its domestic inventories. Accordingly, previously issued third quarter 1987 results have been restated to reflect this change, which reduced third quarter net income by \$1.3 million (3 cents per share). There was no effect on the first and second quarters of 1987.

** Extraordinary Credits:

Tax loss carryforwards	\$ 0.2	\$ —	\$ 0.5	\$ 0.3	\$ 6.9	\$ 3.7	\$ 0.5	\$ —
Union Carbide Investment	20.9	5.6	11.3	1.6	78.9	—	92.0	30.5
Borg-Warner Investment	—	97.1	—	—	—	—	—	—
Total	<u>\$ 21.1</u>	<u>\$102.7</u>	<u>\$ 11.8</u>	<u>\$ 1.9</u>	<u>\$ 85.8</u>	<u>\$ 3.7</u>	<u>\$ 92.5</u>	<u>\$ 30.5</u>

*** In accordance with the provisions of APB Opinion No. 15, earnings per share are calculated separately for each quarter and the full year. Accordingly, annual earnings per share will not necessarily equal the total of the interim periods.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To GAF CORPORATION

We have examined the consolidated balance sheets of GAF Corporation (a Delaware corporation) and subsidiaries as of December 31, 1987 and 1986, and the related consolidated statements of income, changes in financial position and shareholders' equity for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of GAF Corporation and subsidiaries as of December 31, 1987 and 1986, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Our examinations were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules as listed in the index on page F-1 of this Form 10-K are presented for purposes of complying with the Securities and Exchange Commission's rules and are not part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the examinations of the basic financial statements and, in our opinion, fairly state in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN & CO.

Roseland, New Jersey
February 29, 1988

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our report included in this Form 10-K, into the Company's previously filed Registration Statements on Form S-8 (Nos. 2-53686, 2-41036, 2-92203, 2-92202 and 2-336424).

ARTHUR ANDERSEN & CO.

Roseland, New Jersey
March 24, 1988

GAF CORPORATION AND SUBSIDIARIES
MARKETABLE SECURITIES—OTHER INVESTMENTS

As of December 31, 1987

(Dollars in Thousands)

Title of Issue	Principal Amount or Number of Shares	Cost	Market Value At December 31, 1987	Balance Sheet Carrying Amount
SHORT-TERM INVESTMENTS				
(A) DEPOSITS				
Money Market Funds	\$ 6,319	\$ 6,319	\$ 6,319	
Mutual Funds	3,426	3,426	3,214	
Total Deposits	<u>\$ 9,745</u>	<u>\$ 9,745</u>	<u>\$9,533</u>	\$ 9,533
(B) SECURITIES				
(1) Government Securities				
U.S.	\$ 5,639	\$ 5,639	\$ 5,639	
Municipal Bonds	12,000	12,000	12,000	
Foreign	883	883	883	
Total	<u>\$ 18,522</u>	<u>18,522</u>	<u>18,522</u>	
(2) Repurchase Agreements	<u>\$ 41,488</u>	<u>41,488</u>	<u>41,488</u>	
(3) Commercial Paper	<u>\$ 14,499</u>	<u>14,499</u>	<u>14,499</u>	
(4) Common Stock*				
Union Carbide	1,542,061	29,165	33,537	
Aerospace (3)		13,415	11,636	
Transportation (1)		10,131	7,922	
Data Processing (2)		13,495	13,054	
Financial Services (6)		9,929	8,179	
Other (16)		12,344	12,058	
Total		<u>88,479</u>	<u>86,386</u>	
(5) Investment in Securities Limited Partnership .		<u>43,611</u>	<u>43,199</u>	
(6) Preferred stocks(8)*		<u>17,551</u>	<u>16,167</u>	
(7) Bonds and Notes*				
Domestic (10)		22,551	21,139	
Foreign (3)		4,217	4,051	
Total		<u>26,768</u>	<u>25,190</u>	
Total Securities		<u>\$250,918</u>	<u>\$245,451</u>	\$245,451
MARKETABLE SECURITIES				
(A) COMMON STOCK*				
Cabot Corporation	1,346,600	40,898	44,133	
CBI Industries, Inc.	2,030,900	53,778	40,364	
Allied-Signal Inc.	1,418,800	58,718	40,081	
Diversified Commodity Chemical (1)		17,475	17,850	
Diversified Pharmaceutical (1)		17,033	16,657	
Industrial Gases (1)		21,049	21,695	
Diversified Packaging and Consumer (1)		23,969	22,997	
Diversified Aerospace (1)		17,361	15,773	
Diversified Chemical (1)		19,505	19,090	
Diversified Specialty Chemical (1)		20,519	18,659	
Automotive Chemical (1)		7,017	6,124	
Petrochemicals & Energy (1)		11,344	11,871	
Total		<u>308,666</u>	<u>275,294</u>	
(B) OTHER*				
Other (2)		<u>23,684</u>	<u>23,684</u>	
Total Marketable Securities		<u>\$332,350</u>	<u>\$298,978</u>	\$298,978

* Figures in parentheses indicate number of companies in group.

SCHEDULE V

GAF CORPORATION AND SUBSIDIARIES

PROPERTY, PLANT AND EQUIPMENT

Year Ended December 31, 1987
(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1987</u>	<u>Additions at Cost</u>	<u>Retirements</u>	<u>Transfers Between Accounts</u>	<u>Other (b)</u>	<u>Balance December 31, 1987</u>
Land.....	\$ 5,952	\$ 14	\$ 38	\$ 99	\$ 1,921	\$ 7,948
Land improvements.....	10,451	752	50	123	—	11,276
Buildings and building equipment.....	56,814	2,704	1,538	1,012	7,625	66,617
Machinery and equipment.....	240,174	31,266	8,834	(1,234)	10,582	271,954
Construction in progress.....	16,197	31,175(a)	214	—	—	47,158
	<u>\$329,588</u>	<u>\$65,911</u>	<u>\$10,674</u>	<u>\$ —</u>	<u>\$20,128</u>	<u>\$404,953</u>

Year Ended December 31, 1986
(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1986</u>	<u>Additions at Cost</u>	<u>Retirements</u>	<u>Other(c)</u>	<u>Balance December 31, 1986</u>
Land.....	\$ 6,797	\$ 20	\$ 865	\$—	\$ 5,952
Land improvements.....	9,963	547	59	—	10,451
Buildings and building equipment.....	53,631	3,954	771	—	56,814
Machinery and equipment.....	226,387	22,853	12,566	3,500	240,174
Construction in progress.....	11,362	6,540(a)	1,705	—	16,197
	<u>\$308,140</u>	<u>\$33,914</u>	<u>\$15,966</u>	<u>\$3,500</u>	<u>\$329,588</u>

Year Ended December 31, 1985
(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1985</u>	<u>Additions at Cost</u>	<u>Retirements</u>	<u>Other(d)</u>	<u>Balance December 31, 1985</u>
Land.....	\$ 5,807	\$ —	\$ 426	\$1,416	\$ 6,797
Land improvements.....	9,242	817	96	—	9,963
Buildings and building equipment.....	52,558	2,920	3,723	1,876	53,631
Machinery and equipment.....	200,658	42,235	22,464	5,958	226,387
Construction in progress.....	10,182	1,189(a)	9	—	11,362
	<u>\$278,447</u>	<u>\$47,161</u>	<u>\$26,718</u>	<u>\$9,250</u>	<u>\$308,140</u>

NOTES:

(a) Denotes net change during year.

(b) Represents acquisition of Alkaril Chemicals Limited.

(c) Represents acquisition of chemical facilities from Borg-Warner Chemicals, Inc.

(d) Represents acquisition of glass fiber facilities from Reichhold Chemicals, Inc.

The ranges of annual depreciation rates generally were as follows (applied principally on the straight-line basis):

Land improvements.....	4-6½%
Buildings and building equipment.....	2½-20%
Machinery and equipment.....	5-33½%

GAF CORPORATION AND SUBSIDIARIES

ACCUMULATED DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT

Year Ended December 31, 1987

(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1987</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Retirements</u>	<u>Transfers Between Accounts</u>	<u>Balance December 31, 1987</u>
Land improvements.....	\$ 4,010	\$ 397	\$ 33	\$ 2	\$ 4,376
Buildings and building equipment.....	25,534	2,371	1,384	11	26,532
Machinery and equipment.....	91,648	14,938	9,148	(13)	97,425
	<u>\$121,192</u>	<u>\$17,706</u>	<u>\$10,565</u>	<u>\$ —</u>	<u>\$128,333</u>

Year Ended December 31, 1986

(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1986</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Retirements</u>	<u>Balance December 31, 1986</u>
Land improvements.....	\$ 3,626	\$ 460	\$ 76	\$ 4,010
Buildings and building equipment.....	24,417	1,989	872	25,534
Machinery and equipment.....	86,011	15,533	9,896	91,648
	<u>\$114,054</u>	<u>\$17,982</u>	<u>\$10,844</u>	<u>\$121,192</u>

Year Ended December 31, 1985

(Dollars in Thousands)

<u>Classification</u>	<u>Balance January 1, 1985</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Retirements</u>	<u>Balance December 31, 1985</u>
Land improvements.....	\$ 3,236	\$ 500	\$ 110	\$ 3,626
Buildings and building equipment.....	25,945	2,143	3,671	24,417
Machinery and equipment.....	90,151	14,723	18,863	86,011
	<u>\$119,332</u>	<u>\$17,366</u>	<u>\$22,644</u>	<u>\$114,054</u>

SCHEDULE VIII

GAF CORPORATION AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS

Year Ended December 31, 1987

(Dollars in Thousands)

Description	Balance January 1, 1987	Charged to Costs and Expenses	Deductions	Other (b)	Balance December 31, 1987
Valuation and Qualifying Accounts Deducted from Assets to Which They Apply:					
Allowance for doubtful accounts.....	\$4,382	\$ 875	\$1,289(a)	\$142	\$4,110
Allowance for discounts.....	3,826	9,098	8,044	—	4,880
Reserve for inventory market valuation..	5,144	2,082	2,013	60	5,273

Year Ended December 31, 1986

(Dollars in Thousands)

Description	Balance January 1, 1986	Charged to Costs and Expenses	Deductions	Balance December 31, 1986
Valuation and Qualifying Accounts Deducted from Assets to Which They Apply:				
Allowance for doubtful accounts.....	\$5,142	\$2,178	\$2,938(a)	\$4,382
Allowance for discounts.....	1,874	8,782	6,830	3,826
Reserve for inventory market valuation.....	3,627	4,075	2,558	5,144

Year Ended December 31, 1985

(Dollars in Thousands)

Description	Balance January 1, 1985	Charged to Costs and Expenses	Deductions	Balance December 31, 1985
Valuation and Qualifying Accounts Deducted from Assets to Which They Apply:				
Allowance for doubtful accounts.....	\$5,426	\$ 703	\$ 987(a)	\$5,142
Allowance for discounts.....	1,489	7,189	6,804	1,874
Reserve for inventory market valuation.....	4,538	1,356	2,267	3,627

NOTES: (a) Represents write-offs of uncollectible accounts net of recoveries.

(b) Represents reserve assumed in acquisition of Alkaryl Chemicals Limited.